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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-703

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

UNITED STATES OF AMERICA,

Appellant,

—v.—

FIRST NATIONAL BANCORPORATION, INC.,

and

THE FIRST NATIONAL BANK OF GREELEY.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

BRIEF FOR THE FEDERAL DEPOSIT INSURANCE CORPORATION AS *AMICUS CURIAE*

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CORPORATION

INDEX

PAGE

nterest of the FDIC 1

ummary of Argument 3

I. In Analyzing Whether Potential Competition Between Two Banks Is Likely to Become Actual Competition, the Likelihood of Alternative Entry Should Be Assessed on the Basis of Objective Criteria 7

II. The Likelihood of Alternative Entry Should Not Be Decided on the Basis of the Expressed Intent of Management 9

III. The Present Intent of a Chartering Authority Not to Permit *De Novo* Entry Should Not Be Treated as Conclusive 11

IV. The Banking Agencies and the Courts May Properly Consider the Likely Impact of a Proposed Acquisition on Future Competition Within a Broader Area Than the Markets Presently Being Served by the Parties to the Acquisition 12

V. Economies of Scale Do Not Justify the Acquisition of a Significant Local Bank by a Larger Potential Competitor 17

ONCLUSION 21

PPENDIX A 23

PPENDIX B 86

PAGE

TABLE OF AUTHORITIES

Cases:

Bank of Hawaii (FDIC 12/18/70) (p. 59) 4, 5
Brown Shoe Co. v. United States, 370 U.S. 294 (1962) 10, 16
BT New York Corporation, 53 Fed. Reserve Bull. 769 (1967) 4

Continental Bank (FDIC 12/22/71) (p. 52) 4

First-Citizens Bank & Trust Company (FDIC 1/4/71) (p. 30) on reconsideration (7/12/71) (p. 35) 5

The First National Bancorporation, Inc., 56 Fed. Reserve Bull. 731 (1970) 4, 5

United States v. E. I. du Pont de Nemours & Co., 353 U.S. 586 (1957) 16
United States v. Pabst Brewing Co., 384 U.S. 547 (1966) 14
United States v. Penn-Olin Chemical Co., 378 U.S. 158 (1964) 14
United States v. The Philadelphia National Bank, 374 U.S. 321 (1963) 12-13, 16

Washington Mutual Savings Bank (FDIC 12/18/70) (p. 70) on reconsideration (7/30/71) (p. 75) 5
Westminster Trust Company (FDIC 5/14/71) (p. 39) .. 4

Constitutional Provision:

State Constitution

COLO. CONST. art. 12, § 13(8) 11

PAGE

Federal Statutes:

Bank Merger Act, 74 Stat. 129, as amended, 80 Stat. 7, 12 U.S.C. § 1828(c) 2

Section 3(c) of the Bank Holding Company Act of 1956, 70 Stat. 134, as amended, 80 Stat. 237, 12 U.S.C. § 1842(c) 2

§ 1842(d) 13

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 64 Stat. 1125, 15 U.S.C. § 18 ..... 2, 10, 12

State Statutes:

COLO. REV. STAT. 1963 § 14-3-1 (1969) 13

IND. STAT. ANN. tit. 18, § 18-1707 (Supp. 1971) 13

KY. STAT. ANN. § 287.180 (Supp. 1967) 13

ORE. REV. STAT. §§ 714.050, 714.060 (1953) 13

PA. STAT. ANN. tit. 7, § 904 (1957) 13
§ 6003 (1957) 13

VA. CODE ANN. § 6.1-39(a), (c) (1966) 13

Other Authorities:

Comment, 71 *Yale L. J.* 502 (1962) 11

53 Fed. Reserve Bull. 769 (1967) 4
56 Fed. Reserve Bull. 731 (1970) 4, 5
H.R. Rep. No. 1416, 86th Cong., 2d Sess. (1960) 10
H.R. Rep. No. 1221, 89th Cong., 2d Sess. (1966) 10
S. Rep. No. 1095, 84th Cong., 1st Sess. (1955) 10

PAGE

S. Rep. No. 196, 86th Cong., 1st Sess. (1959) 11
S. Rep. No. 196, 86th Cong., 1st Sess. (1960) 10
S. Rep. No. 1179, 89th Cong., 2d Sess. (1966) 10

Alhadeff, *Monopoly and Competition in Banking* (Berkeley University of California, 1954) 17

Bell and Murphy, *Costs in Commercial Banking: A Quantitative Analysis of Bank Behavior and Its Relation to Bank Regulation,* Research Report No. 41, Federal Reserve Bank of Boston, April 1968 18
Benston, "Economies of Scale and Marginal Costs in Banking Operations," *The National Banking Review,* II (June 1965) 18

Guttentag and Herman, "Banking Structure and Performance," *The Bulletin,* Institute of Finance, Graduate School of Business Administration, New York University, No. 41-43 (February 1967) 17

Horvitz, "Economies of Scale in Banking," in Commission on Money and Credit, *Private Financial Institutions* (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1963) 17, 18

Kohn and Carlo, *Potential Competition: Unfounded Faith or Pragmatic Foresight?* (N. Y. State Banking Dept. March 1970) 8

Schweiger and McGee, "Chicago Banking," *The Journal of Business,* XXXIV (July 1961) 17

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Interest of the FDIC

The Federal Deposit Insurance Corporation ("FDIC") nsures deposits in all national banks, in all state banks hich are members of the Federal Reserve System, and n all nonmember state banks which apply for federal eposit insurance and meet appropriate standards. It has pecific supervisory responsibilities, however, only with espect to federally insured state banks which are not nembers of the Federal Reserve System. These responsi-ilities include, among other things, the periodic examina-ion of such banks and the approval or disapproval of

applications for mergers, consolidations, acquisitions, and assumption transactions between insured banks where the acquiring, assuming or resulting bank is to be an insured nonmember state bank. The Comptroller of the Currency exercises similar functions with respect to national banks and the Board of Governors of the Federal Reserve System fills the same role with respect to state banks that are members of the Federal Reserve System. In addition, the FDIC is responsible for approving or disapproving merger-type transactions between any insured bank and a noninsured bank or institution. Of the 14,273 banks in the United States at the end of 1971, the FDIC had specific supervisory responsibility for 7,875 state-chartered commercial banks not members of the Federal Reserve System and 326 mutual savings banks. Since the effective date (May 13, 1960) of the Bank Merger Act, 74 Stat. 129, as amended, 80 Stat. 7, 12 U.S.C. § 1828(c), the FDIC, through December 1971, has passed on 546 applications for mergers or other proposals falling within the purview of that Act.

In carrying out its responsibilities under the Bank Merger Act, the FDIC must apply standards that are identical to those contained in Section 3(c) of the Bank Holding Company Act of 1956, 70 Stat. 134, as amended, 80 Stat. 237, 12 U.S.C. § 1842(c). The latter, and Section 7 of the Clayton Act, 38 Stat. 731, as amended, 64 Stat. 1125, 15 U.S.C. § 18, are the principal statutes involved in this proceeding.

The FDIC does not supervise First National Bancorporation, Inc., its principal subsidiary, First National Bank of Denver, or First National Bank of Greeley, and it has had no recent application involving banking markets in the State of Colorado that required an FDIC decision

der the Bank Merger Act. FDIC accordingly has no nments to offer regarding the facts involved in this gation and is not recommending either affirmance or ersal.

The sole interest of the FDIC in this case is that certain nciples relating to potential competition and banking ucture, which it believes are valid and essential if the ited States is to have meaningful competition among nmercial banks in the future, be taken into consideration the Court in the expression of its opinion. Questions ating to these principles are raised in this proceeding t have not heretofore been addressed by the Court in or opinions involving proposed bank acquisitions. The urt's disposition of these questions, and its statements h regard to such questions, will have important impli-ions for future decisions under the Bank Merger Act by h of the federal agencies which administers the Act, luding FDIC, and profound significance for the future ucture of the nation's commercial bank industry.

Summary of Argument

Proposed bank mergers frequently require agency con-eration of several different effects of the proposed nsaction on competition. The primary concern in most nk merger cases considered by the various agencies and this Court since 1960 has been the possible elimination existing competition between the banks proposed to be rged. That issue does not appear to be a major one in s proceeding. This case rests instead on issues of tential competition in the future between the acquiring npany and the bank it seeks to acquire, and on issues

involving the future structure of commercial banking in a particular state.[1]

At least in recent years, the banking agencies have regularly examined the possible elimination of potential competition between two applicants in analyzing bank merger and bank holding company applications. Such an analysis may lead to agency denial of applications to merge or acquire a bank in a particular local market, in an effort to force the applicant organization to consider alternative means of entry and thereby encourage a larger number of competing institutions in that market in the future.[2] Even if only one or two organizations deemed to be significant potential competitors of the local bank become its actual competitors in the future, the choices available to the public for banking services in that market may be significantly enlarged over the choices available at the time the proposed merger or acquisition was denied. The FDIC believes that the banking agencies can and should reach conclusions as to the likelihood that potential competition will become actual competition on the basis of objective criteria and not statements of present intentions by bank management or bank chartering authorities.

In addition to analyzing the possible elimination of potential competition between the parties to a proposed

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[1] For representative opinions by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the FDIC denying applications at least in part on such issues, see Appendix A.

[2] See the opinions cited in Appendix A, particularly The First National Bancorporation, Inc., 56 Fed. Reserve Bull. 731 (1970); BT New York Corporation, 53 Fed. Reserve Bull. 769 (1967). See also the FDIC opinions reproduced in Appendix A, particularly Continental Bank (FDIC 12/22/71) (p. 52); Westminster Trust Company (FDIC 5/14/71) (p. 39); Bank of Hawaii (FDIC 12/18/70) (p. 59).

acquisition, the FDIC since early 1970 and the Board of Governors of the Federal Reserve System since at least 1962 have reviewed the effect the proposed acquisition may have on the present and future banking structure of geographic areas larger than the areas then being served by the banks involved.[3] For purposes of this review, the relevant geographic area is the largest area in which, under state law, a bank may merge or branch *de novo* or in which a bank holding company may acquire a bank. Since only sixteen states, by affirmative legislation, have prohibited bank holding companies from acquiring banks in different local markets, the larger area typically examined by FDIC for this purpose, as it would be in Colorado, is the entire state.

In such states, a high concentration of statewide commercial banking resources in the hands of a few banks may effectively limit the public's choice of alternative sources for many banking services. It may also reduce the likelihood of future new entrants into local banking markets throughout the state if the largest statewide banks are already represented in such markets. Moreover, in such states mergers of smaller banks with the state's largest banks, even where no substantial existing or potential competition between the two is likely to be eliminated, may also foreclose the development of other banks fully able to compete with those largest banks by denying such emerging competitors opportunities to grow by merger with the same small banks.

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[3] See the opinions cited in Appendix A, particularly The First National Bancorporation, Inc., 56 Fed. Reserve Bull. 731 (1970). See also the FDIC opinions reproduced in Appendix A, particularly First-Citizens Bank & Trust Company (FDIC 1/4/71) (p. 30) on reconsideration (7/12/71) (p. 35); Bank of Hawaii (FDIC 12/18/70) (p. 59); Washington Mutual Savings Bank (FDIC 12/18/70) (p. 70) on reconsideration (7/30/71) (p. 75). (The latter case is in litigation; see p. 85).

In states where statewide branching or merging or statewide holding company acquisitions are allowed, and where a state's commercial banking resources are already highly concentrated, the agencies administering the Bank Merger Act and Bank Holding Company Act must be allowed to check in their incipiency further increases in statewide concentration levels which may arise from acquisition proposals (i) that in and of themselves produce an undue concentration of such banking resources measured on a statewide basis, or (ii) that add to existing high levels of concentration statewide, or (iii) that produce, in separate local banking markets in the state, adjacent oligopolies in which the same large banks are the only convenient alternatives for banking services.

The relevant statutes can and should be interpreted by the banking agencies and the Federal courts to prohibit proposed acquisitions that have these results not merely within the relevant area of existing competition, but also within that area within which banks may branch or merge or in which holding companies may operate, whether or not a specific proposed transaction is likely to eliminate substantial potential competition between the acquiring organization and the bank sought to be acquired.

Finally, it is frequently argued in bank acquisition cases that otherwise anticompetitive transactions should be allowed because the proposed acquisition is the only means by which the applicants can achieve economies of scale and hence provide banking services at lower cost to existing or prospective customers. Existing literature as well as recent studies by the FDIC cast doubt on the view that economies of scale are significant in banking. While there are advantages, other than economies of scale, which large

banks have, these suggest that larger banks should be encouraged to enter new markets *de novo* or by "foothold" acquisitions rather than by the acquisition of a significant competitor already in the market.

I.

In Analyzing Whether Potential Competition Between Two Banks Is Likely to Become Actual Competition, the Likelihood of Alternative Entry Should Be Assessed on the Basis of Objective Criteria.

Reasonable judgments can be made by the banking agencies and the courts as to the likelihood that potential competition between two parties to a proposed acquisition will become actual competition in the future based on objective criteria that in simplified form reduce to two factors: (1) the capacity of either firm to enter the banking market of the other, or some mutually desired third market, by means other than the proposed acquisition; and (2) the attractiveness of the particular market in question. Capacity, in this sense, is essentially a function of size, financial strength and managerial resources and experience. The attractiveness of the market is determined by such considerations as the nature of the local economy, income levels in the market, the number of commercial banks and banking offices serving the market, the vigor of the competition likely to be encountered and the area's growth potential and prospects. Supervisory experience with *de novo* entry or the acquisition of a smaller bank than the one sought to be acquired in the same or similar markets is also relevant to an agency or judicial determination on both points. Each federal bank supervisory agency has

experience with applications for *de novo* entry into new markets by banks under its supervision, either by the establishment of branch offices or by the establishment of newly-chartered affiliates. Each agency has, therefore, some expertise regarding the characteristics of banking markets which attract efforts at entry and as to the capacity of individual banks or banking organizations to effect entry into a given market by means other than a proposed acquisition.[4]

A 1970 study by the New York State Banking Department vindicates the use of objective criteria for analyzing potential competition between two parties to a proposed acquisition. In 10 of 13 cases in which potential competition was, or could have been, utilized as a decisive factor by the bank regulatory authorities in denying a bank merger or a bank holding company application in the State of New York, potential competition eventually became actual competition.[5] Since the FDIC did not deny merger applications prior to 1970 on the basis that potential competition between the parties might become actual competition, too little time has elapsed to determine in how many cases the potential competition involved in mergers denied by the FDIC since 1970 will become actual competition.[6]

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[4] The FDIC, for example, disposed of 647 applications for *de novo* branches (not including 115 applications for *de novo* "facilities", i.e., limited purpose branches) and 169 applications for insurance of newly-chartered state banks during the calendar year 1971.

[5] Kohn and Carlo, *Potential Competition: Unfounded Faith or Pragmatic Foresight?* (N. Y. State Banking Dept. March 1970).

[6] One merger denied by the FDIC during that period tends to support the New York experience. Subsequent to the denial on

II.

The Likelihood of Alternative Entry Should Not Be Decided on the Basis of the Expressed Intent of Management.

The question whether a bank, or bank holding company, is likely to enter a new geographic market if it were not permitted to acquire an established bank in that market should not be resolved on the basis of expressions of present management intentions. Management is charged with the responsibility of maximizing profits. Entering a new market by acquiring a viable bank already operating there may be less expensive and more immediately profitable to the entering bank than entry by *de novo* expansion or by means of a smaller "foothold" acquisition. Entry by acquisition of a leading local bank also removes a significant competitor for the entering firm or one which might become a significant competitor to the entering firm through future expansion moves of its own, either by merger or *de novo* branching. For these reasons, and because of the greater resources and profit potential to be obtained, the acquisition of the largest available bank is usually preferable from management's standpoint. Thus, whenever there appears to be a reasonable chance that entry into a new market can be effected through the acquisition of a large, viable, existing bank, management is likely to pursue that course and, in an advocacy role, to contend that, if denied the proposed acquisition, it would not seek to enter by some alternative means.

September 4, 1970, of a proposed merger between Valley Fidelity Bank and Trust Co., Knoxville, Tennessee, and Bank of Knoxville, the former applied for a *de novo* office, which has been approved; Bank of Knoxville has received approval for and opened three *de novo* offices. All the branches are in the market area shared by the banks.

For their part, the owners of a bank proposed to be disposed of may well favor a merger or holding company acquisition over an outright sale of stock because of tax considerations or the greater marketability of the stock to be acquired. Once that basic decision is made, they would in most cases prefer to be acquired by the firm offering them the highest premium. The bank, or holding company, willing and able to pay the highest premium is typically one of the largest institutions in the potential market—the same institutions best able to enter *de novo* or by some smaller "foothold" entry.

In sum, the self-interest of the owners and managers of both selling and acquiring institutions causes them generally to favor, and argue for, amalgamations that may be the least desirable from the standpoint of encouraging the greatest public choice of banking alternatives within given markets. Deciding the probabilities of alternative entry on the basis of the expressed intent of managers and owners of banks or bank holding companies could seriously frustrate the purposes of the Bank Merger Act and the Bank Holding Company Act, as well as of Section 7 of the Clayton Act. *See* S. Rep. No. 196, 86th Cong., 1st Sess. (1960); H.R. Rep. No. 1416, 86th Cong., 2d Sess. (1960); H.R. Rep. No. 1221, 89th Cong., 2d Sess. (1966); S. Rep. No. 1095, 84th Cong., 1st Sess. (1955); S. Rep. No. 1179, 89th Cong., 2d Sess. (1966); *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 317 (1962).

III.

The Present Intent of a Chartering Authority Not to rmit *De Novo* Entry Should Not Be Treated as Con- sive.

A statement by a chartering authority that it will not horize *de novo* entry should not be regarded as con- sive on the question of alternative entry. First, the rtering authority may change its mind if conditions in market area in question change (or the supervisor, self, may change, with a resulting change in policy).[7] ond, for commercial banks, there are always two pos- e chartering authorities: state or federal. A bank that lissatisfied with the policies of one authority can change status by conversion in order to come under the juris- tion of the other. Third, under most state laws, pros- ts for profitable operations appear to be the key sideration for a favorable finding on a new bank or nch application; the preservation or improvement of l competition is typically not a statutory consideration l appears to receive little attention by state bank super- ors under "public interest" or "public convenience and ds" criteria.[8] Such chartering laws and policies are at

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Since January 1, 1967, there have been 67 appointments of State Bank Supervisors, reflecting multiple changes in some es and at least one change in 39 of the 50 states. Fourteen nges occurred in 1971. In Colorado, the current supervisor been in office since January 1, 1965, and will hold his position ring efficient service or until reaching retirement age." COLO. ST. art. 12, § 13(8).

See, e.g., Comment, 71 *Yale L. J.* 502, 511 (1962); *S. Rep. No.* , 86th Cong., 1st Sess. 1 (1959).

odds with the underlying purposes of the Bank Merger Act and the Bank Holding Company Act, and if the likelihood of alternative entry is resolved on the basis of the present intentions of chartering authorities, then the purposes of both acts, as well as the purpose of Section 7 of the Clayton Act, could be seriously frustrated.

IV.

The Banking Agencies and the Courts May Properly Consider the Likely Impact of a Proposed Acquisition on Future Competition Within a Broader Area Than the Markets Presently Being Served by the Parties to the Acquisition.

In bank acquisition cases, the areas in which the two parties to the transaction may find themselves in competition in the future, if the acquisition does not occur, are only rarely limited to the same areas in which they are offering banking services at the time of the application. This is because state law, rather than the past branching decisions of their managements, defines the locations at which two banking organizations can receive deposits and carry on the full range of banking services. If the banking agencies and the courts are to complete their analysis of whether the effect of a proposed acquisition "in any section of the country may be substantially to lessen competition," they would appear to be required, by statutory direction, to consider the competitive impact of the proposal not merely in the market areas where the two parties presently have offices, but also in the widest geographic area under state law within which the banks may merge, branch *de novo* or have bank holding company affiliates. Cf. *United*

States v. *The Philadelphia National Bank*, 374 U.S. 321, 359 (1963). In the thirty-four states like Colorado where multibank holding companies are not affirmatively prohibited by state law, this relevant geographic area of inquiry would be the entire state.[9] In the remaining sixteen states where multibank holding companies are prohibited by state law, and state law further limits *de novo* branching or merging by commercial banks to some area smaller than the entire state, this relevant geographic area of inquiry would be that smaller area.[10] These areas of inquiry are not always banking markets in economic terms, but they have been made relevant to the competitive analysis by

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[9] *See* COLO. REV. STAT. 1963 § 14-3-1 (1969). Out-of-state holding companies may not expand into Colorado. 12 U.S.C. § 1842(d). Variations in different states are frequently unique. Virginia, for example, with qualifications that are not material here, permits a bank to branch *de novo* only in the city, town or county in which it is headquartered and in a contiguous city, or county; but Virginia does permit the establishment of branches through merger statewide and also permits multibank holding companies statewide. VA. CODE ANN. § 6.1-39(a), (c) (1966). Oregon allows statewide branching by merger, even though a *de novo* branch may not be established in a community with a population of less than 50,000 if an existing bank is headquartered there. ORE. REV. STAT. §§ 714.050, 714.060 (1953).

[10] Pennsylvania, for example, prohibits multibank holding companies, PA. STAT. ANN. tit. 7, § 6003 (1967), but allows commercial banks to branch *de novo* or merge, with appropriate supervisory approval, in their home county and in all counties adjacent to the home county. *Id.* § 904. For the reasons indicated, FDIC attempts to analyze the likely competitive impact of proposed bank mergers in Pennsylvania not merely in the markets currently served by the two banks, but also in the multicounty area around each home office where the two banks can merge or branch *de novo*. In other states, this relevant geographic area of inquiry might be limited to a differently constituted multicounty region or to the home county of one or both parties. *See, e.g.*, IND. STAT. ANN. tit. 18, § 18-1707 (Supp. 1971) (restricting branches to the county in which the bank maintains its principal office); KY. STAT. ANN. § 287.180 (Supp. 1967) (restricting branches to the county in which the bank maintains its principal office).

state law since they define the geographic area of possible future competition between the parties to the proposed acquisition and between such parties and other banking organizations. Cf. *United States* v. *Pabst Brewing Co.*, 384 U.S. 547, 549 (1966).

Restricting this discussion to states like Colorado in which multibank holding companies are permitted to operate statewide,[11] the banking agencies and the courts would appear to be justified in seeking to determine whether a proposed acquisition would have substantial anticompetitive effects on a statewide basis. They may inquire, for example, whether the two parties involved in the proposed acquisition, if the proposed acquisition is denied, are likely to become competitors in some mutually desired banking market within the state in which neither presently operates, and whether the effect of the proposed acquisition "may be substantially to lessen competition" in that market. It is important to preserve the more likely potential entrants when markets are concentrated, as they frequently are in banking. Further, the mere presence of a potential entrant —even though the probability of entry is small—can have important implications for competition. *United States* v. *Penn-Olin Chemical Co.*, 378 U.S. 158, 173-74 (1964). Even where future competition between the two parties to a proposed transaction is found to be unlikely on the basis of objective criteria, or where such competition even if likely would have no substantial anticompetitive effect in any local banking market, the banking agencies and the courts should look beyond the two parties to the transac-

[11] Similar inquiries confined to a geographic area less than the entire state would, however, be relevant in states which bar multibank holding companies but permit countywide, multicounty, or regional branching or merging. See the preceding footnote.

tion to determine if their consolidation or affiliation would have substantial anticompetitive effects on the future structure of commercial banking in the state as a whole.[12]

Thus, they may consider it necessary to deny a particular acquisition in order to prevent or to minimize an undue concentration of the total commercial banking resources of a particular state. A high concentration of statewide commercial banking resources in the hands of a few banks may effectively limit the public's choice of alternative sources for many banking services. It may also reduce the likelihood of future new entrants into local banking markets throughout the state if the largest statewide banks are already represented in such markets. Such a market structure, in which a small number of banks hold large shares of the banking business in each of the several local banking markets that make up the state, is also undesirable because it is conducive to parallel practices and parallel pricing by the existing firms in the market. Consumers of banking service seeking variations in such practices or prices would then be faced with the same alternatives in any other market to which they turned. Moreover, in highly concentrated states, mergers of small banks with the state's largest banks, even where no substantial existing or potential competition between the two is likely to be eliminated, may have the effect of foreclosing the development of other banks fully able to compete with those

[12] It should be noted that the applicable statutory language found in the Bank Merger Act, the Bank Holding Company Act and the Clayton Act does not require a substantial lessening of competition *between the parties to the proposed transaction.* This omission makes possible consideration of any trends toward excessive concentration in the relevant area and consideration of other structural deficiencies which, for example, might inhibit the entry of outside competitors or otherwise restrict competition among commercial banks in the area in the future.

largest banks by denying such emerging competitors opportunities to grow by merger with the same small banks.

In states where statewide branching or merging or statewide holding company acquisitions are allowed, and where a state's banking resources are already highly concentrated, it would seem that the agencies administering the Bank Merger Act and the Bank Holding Company Act and the courts, if they are to prevent a substantial lessening of competition among commercial banks in the state in the future, must be allowed to check in their incipiency further increases in statewide concentration levels which may arise from acquisition proposals (i) that in and of themselves produce an undue concentration of such banking resources measured on a statewide basis, or (ii) that add to existing high levels of concentration statewide, or (iii) that produce, in separate local banking markets in the state, adjacent oligopolies in which the same large banks are the only convenient alternatives for banking services. *See, e.g., United States* v. *Philadelphia National Bank,* 374 U.S. 321, 362 (1963); *Brown Shoe Co.* v. *United States,* 370 U.S. 294, 317-18 (1960); *United States* v. *E. I. du Pont de Nemours & Co.,* 353 U.S. 586, 589 (1957).

V.

Economies of Scale Do Not Justify the Acquisition of a Significant Local Bank by a Larger Potential Competitor.

The argument is frequently made in bank acquisition cases that an otherwise anticompetitive transaction is in the public interest because it allows the applicants to achieve economies of scale, and hence to provide existing or potential customers with banking services at lower cost. *De novo* entry into a new market may, it is argued, fragment banking resources and result in banking activities being carried on at a less efficient scale of operations.

The question of whether economies of scale are sufficient in banking to outweigh the anticompetitive effects of an acquisition should be resolved on the basis of the best empirical evidence available. Numerous studies of economies of scale in banking have been reported in the literature, and the FDIC has carried out several intensive investigations of this issue.

The published evidence indicates that as the size of a single banking *office* increases, it is probable that economies of scale occur. However, as the size of a banking *organization* expands through the acquisition of additional offices, no appreciable economies of scale occur.[13] The implication

[13] See Jack M. Guttentag and Edward S. Herman, "Banking Structure and Performance," *The Bulletin*, Institute of Finance, Graduate School of Business Administration, New York University, No. 41-43 (February 1967), pp. 106-108; David A. Alhadeff, *Monopoly and Competition in Banking* (Berkeley: University of California, 1954); Irving Schweiger and John S. McGee, "Chicago Banking," *The Journal of Business*, XXXIV (July 1961), pp. 203-366; Paul M. Horvitz, "Economies of Scale in Banking," in Commission on Money and Credit, *Private Financial Institutions* (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1963).

of the two conclusions is that consolidation of unit banks into multi-office or multi-bank organizations does not result in significant economies of scale in operations.[14]

Recent FDIC analysis of the 1968 operating costs of a nationwide sampling of 972 banks supports these findings. The FDIC study analyzed seven basic commercial bank services: demand deposits, time deposits, installment loans, business loans, real estate loans, securities investment and safe deposit box services. In the case of servicing demand deposits (a function which accounts in the typical bank for a majority of bank employees and for the largest component of direct costs), with a 10 percent increase in accounts, the cost of servicing such accounts increased only slightly less—9.771 percent. For three other functions—time deposits, installment loan functions and safe deposit box services—no significant economies or diseconomies of scale were found. Economies of scale existed in the three remaining areas: business loans, real estate loans, and securities and investments. For a 10 percent increase in output, costs increased 8.761 percent for business loans, 8.139 percent for real estate loans, and 8.245 percent for securities and investments.

Whether economies of scale are of sufficient magnitude to justify a limit on the number of banking offices in a local banking market requires a determination of how costs are affected when differing numbers of banking offices provide the same total quantity of services in the market. Analyti-

[14] *See* Horvitz, *op. cit.*, p. 52; George J. Benston, "Economies of Scale and Marginal Costs in Banking Operations," *The National Banking Review*, II (June 1965), pp. 507-49. Frederick W. Bell and Neil B. Murphy, *Costs in Commercial Banking: A Quantitative Analysis of Bank Behavior and Its Relation to Bank Regulation, Research Report No. 41*, Federal Reserve Bank of Boston, April 1968.

cal techniques derived from Bell and Murphy's study can be applied to data from the Federal Reserve's 1970 Functional Cost Analysis Program for 665 banks ranging up to $50 million in total deposits in order to determine how different numbers of offices affect the total cost of producing a given quantity of services. The results of this analysis are shown in the table below.[15]

Average Expenses Per $100 of Total Assets in a Local Banking Market With a Capacity of $150,000,000 in Total Assets Given Differing Numbers of Equal-Sized Banks

Number of Banks	Average Total Assets Per Bank	Average Expenses Per $100 of Total Assets
3	$50,000,000	$5.02
4	37,500,000	5.08
5	30,000,000	5.13
6	25,000,000	5.16
7	21,429,000	5.20
8	18,750,000	5.22
9	16,667,000	5.25
10	15,000,000	5.27
15	10,000,000	5.35

The table assumes a local banking market that has a demand for commercial banking services equivalent to total assets in the market of $150 million. Given this level of total resources, the average proportion controlled by any one bank declines as the number of banks increases in the market. The table assumes that each bank is the same size and has the same composition of assets and liabilities as those which exist for the typical bank with less than $50 million of deposits.

[15] The derivation of the table from statistical data available to the FDIC is shown in Appendix B.

The table shows that an increase in the number of banks from 3 to 15 results in a 6.6 percent increase in average and total costs and an increase in the number of banks from 7 to 8 causes only a 0.4 percent increase in average and total costs. This indicates that the loss of economies of scale attendant upon a local banking market when a new bank enters the market is not substantial. In fact, several banks could enter a market the size of that in the table without increasing the total costs of producing banking services in the market substantially.

These results of analysis of economies of scale do not mean that the operations of large banks and small banks are identical. Large banks have several advantages, since the same operating expense ratios as a smaller bank would permit the larger bank to spend more dollars for particular functions and yet show the same degree of profitability. These additional dollars are frequently spent to develop and promote specialized services a smaller institution cannot afford to offer and to advertise and promote its services with greater impact in the market than a smaller bank.

These advantages suggest that a large bank or bank holding company entering a new market *de novo* or by means of a "foothold" acquisition can become a viable and a significant competitive force in that market in a shorter time than a small bank or a newly organized bank which does not have the same resources to help it diversify and to promote its banking services. Since both can apparently offer the same basic banking services at approximately equal efficiency, while the larger firm has an ability to penetrate the market more quickly, it would be conducive to greater public choice and the deconcen-

ation of local banking markets if larger firms were re-uired to make their entry to new markets *de novo* or by ie acquisition of a small and relatively insignificant local ompetitor rather than by acquisition of an institution hich is already a significant competitive factor in the ocal market.

CONCLUSION

The banking agencies and the courts should examine the kely impact of a proposed acquisition on future compe-tion between the parties and on future competition be-veen commercial banks generally, not merely in the anking markets in which the parties operate at the time f application, but also in the widest geographic area nder state law in which the parties are permitted to ranch *de novo,* to merge or to have banking affiliates. n determining the likelihood of increased competition be-veen the parties in the future if the proposed acquisition not consummated, the banking agencies and the courts ould be guided by objective criteria, not the present tentions of bank management or bank chartering au-orities. Considerations of future bank structure in the idest geographic area in which the parties may expand nder state law may well lead to the denial of a pro-osed acquisition even though no substantial existing or otential competition between the parties themselves ould be eliminated by consummation of the acquisition. urther, the notion that economies of scale in banking ecessitate concentrated local markets because banks must large to be efficient is not supported by the available idence. Purported economies of scale, for this reason, ould not be allowed to justify an acquisition that might

otherwise substantially lessen competition in any relevant area.

Respectfully submitted,

WILLIAM E. MURANE
General Counsel

J. WILLIAM VIA, JR.
Counsel

on behalf of:

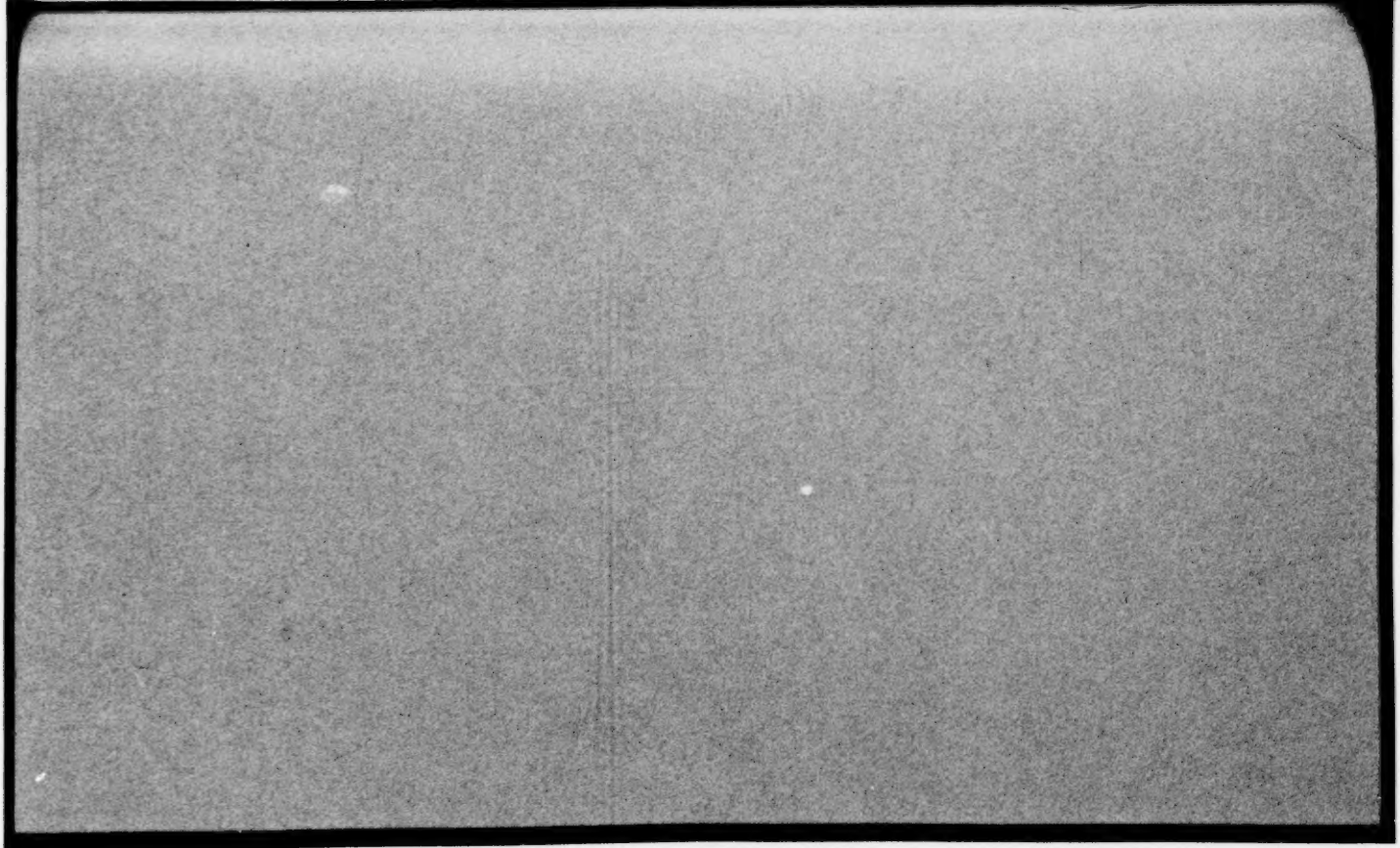
FEDERAL DEPOSIT INSURANCE CORPORATION

I authorize the filing of the above brief.

ERWIN N. GRISWOLD
Solicitor General

May 1972

APPENDICES



APPENDIX A

Central Wisconsin Bankshares, Inc., 52 Fed. Reserve Bull. 29, *petition for reconsideration and hearing denied,* 52 Fed. Reserve Bull. 812 (1966).

The First National Bancorporation, Inc., 57 Fed. Reserve Bull. 47 (1971).

First at Orlando Corporation, 57 Fed. Reserve Bull. 1013, 1014 (1971).

Midlantic Banks Inc., 57 Fed. Reserve Bull. 684 (1971).

The First National Bancorporation, Inc., 56 Fed. Reserve Bull. 731 (1970).

Allied Bankshares Corp., 53 Fed. Reserve Bull. 763 (1967).

BT New York Corporation, 53 Fed. Reserve Bull. 769 (1967).

The Citizens Banking Company, 54 Fed. Reserve Bull. 82 (1968).

Charter New York Corporation, 54 Fed. Reserve Bull. 925 (1968).

The Citizens Banking Company, 54 Fed. Reserve Bull. 82 (1968).

Virginia National Bankshares, Inc., 58 Fed. Reserve Bull. —— (April 26, 1972).

First National City Bank of New York, 1962 Annual Report, Comptroller of the Currency 138.

First National Bank of Oregon, *id.* at 151.

Maryland National Bank, 1963 Annual Report, Comptroller of the Currency 229.

For the Court's convenience, the following FDIC opinions are reprinted in their entirety.

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Valley Fidelity Bank and Trust Company, Knoxville, Tennessee
Application for Consent to Merge and Establish Three Branches

BASIS FOR CORPORATION DENIAL

Valley Fidelity Bank and Trust Company, Knoxville, Tennessee (Valley Fidelity), a state nonmember insured bank with total deposits of $62,690,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior consent to merge under its charter and the title Valley Fidelity Bank of Knoxville, with Bank of Knoxville, Knoxville, Tennessee, an insured state nonmember bank with total deposits of $25,503,000,[1] and for consent to establish three branches at the locations of Bank of Knoxville's main office, a drive-in facility, and an authorized but unopened branch. The proposed merger would give the resulting bank eight operating offices and two authorized but unopened offices.

Competition. Under the Bank Merger Act of 1966, as interpreted by the United States Supreme Court, it is clear that the appropriate banking agency, no less than the lower Federal Courts, is required, in assessing the merits of a typical bank merger, to engage in a two-step process, the first of which is to decide whether the transaction would violate the antitrust prohibitions of Section 7 of the Clayton Act. If such a violation is found, the agency or the court must then decide whether "the anticompetitive effects

[1] Figures as of December 31, 1969.

of the proposed transaction are clearly out-weighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served." The agencies and the lower Federal courts have been further advised that in the second step of the process, the burden of proof is on the merging banks to show that the probable effect of the transaction in meeting the convenience and needs of the public is likely to benefit all seekers of banking services in the area of competitive impact, rather than merely those interested in large loan and trust services, and that the expected gains in convenience and needs cannot reasonably be achieved through other, less anticompetitive, means.[2]

For purposes of the Section 7 analysis of the merger now before the Corporation, Knox County (estimated population 269,000) may be considered the largest geographic area within which a merger of Valley Fidelity and Bank of Knoxville would have competitive significance. Knox County is the area from which both banks derive the bulk of their banking business, it is the area of reasonable banking choice for most customers of the two banks, and it is the geographic area to which the two banks and their competitors are limited by Tennessee law in the establishment of offices.

Only six commercial banks are headquartered in Knox County. Valley Fidelity ranks third in deposit size among them, with 12.4% of all commercial bank deposits in Knox County, and Bank of Knoxville fifth, with 5.0% of all commercial bank deposits in Knox County. The other banks

[2] *United States* v. *First City National Bank of Houston*, 386 U.S. 361 (1967); *United States* v. *Third National Bank in Nashville*, 390 U.S. 171 (1968); and *United States* v. *Phillipsburg National Bank*, 390 U.S. 171 (1970).

in Knox County, and the comparable deposit share for each is as follows:

	Deposits	% Total
Hamilton National Bank of Knoxville	$213,088,000	42.2%
Park National Bank of Knoxville	152,511,000	30.2%
Fountain City Bank	39,916,000	7.9%
Volunteer State Bank (established 1964)	10,862,000	2.2%

The relative shares held by each bank of all commercial bank assets, loans and IPC demand deposits in Knox County are not materially different. With the exception of Fountain City Bank, all of the banks in Knox County have their main offices in downtown Knoxville.

Bank of Knoxville's main office is in the same block as Valley Fidelity's main office, and its only other office, a drive-in facility, is two blocks away. The two banks are not significant competitors at the present time for certain types of commercial bank business, but they are significant competitors for IPC demand deposits, for time and savings deposits, for commercial and industrial loans, for single payment loans to individuals, for residential loans and for instalment loans. Changes in management policy and additional de novo branches, moreover, could bring both banks, as independent institutions, into increasing competition with each other in the future. Their merger would obviously eliminate both existing and potential competition between them.

A comparison with the facts recently before the United States Supreme Court in the *Phillipsburg* case compels the conclusion that a merger of Valley Fidelity with Bank of Knoxville would violate Section 7 of the Clayton Act. In that case, seven commercial banks were found to be competitors in the relevant geographic market. Here, there are six. The banks there seeking to merge ranked third and fifth among the seven, the larger having 13.7% of the total commercial bank deposits in the market. Here Valley Fidelity ranks third and Bank of Knoxville fifth among the competing banks, with Valley Fidelity holding 12.4% of the total commercial bank deposits in the market. There, the largest bank held 41.4% of all the commercial bank deposits in the market. Here, the largest bank holds 42.2%. There, the merger increased the share of deposits held by the three largest banks from 70% to 80%. Here, the comparable percentage would be increased from 85% to 90%. There, as here, the applicants made the claim that they are too small to serve their community effectively and to compete vigorously, and that the proposed merger would have pro-competitive effects by enhancing their competitive position against larger banks. The Court's response was that "such considerations are certainly relevant in determining the 'convenience and needs of the community' under the Bank Merger Act, [but] they are not persuasive in the context of the Clayton Act."

The Corporation finds, accordingly, that the effect of the proposed merger "may be substantially to lessen competition" in commercial banking in Knox County within the meaning of Section 7 of the Clayton Act, as incorporated into the relevant provisions of the Bank Merger Act of 1966.

Convenience and Needs of the Community to be Served. Customers of Bank of Knoxville would undoubtedly benefit from the more aggressive and innovative management of Valley Fidelity, the greater variety of specialized credit services now offered by Valley Fidelity and the extension of trust services presently available at Valley Fidelity but not at Bank of Knoxville. Customers of both banks would derive the benefit of the larger lending limits of the resulting bank and the possible introduction of new services for business customers. In addition, the applicants claim that the resulting bank would expand by a minimum of $4 million Valley Fidelity's present mortgage servicing operation, which is apparently unique among Knox County commercial banks, and that the banking public throughout Knox County would benefit significantly from the prompt establishment of new commercial bank branch offices in areas of the County not now conveniently served.

The claims related to trust services and the more convenient servicing of certain business customers are not compelling. Trust services are now available at several of the downtown Knoxville banks within convenient walking distance of Bank of Knoxville. The demand for the services that might be made available to business customers has not been demonstrated, and the increment in Valley Fidelity's lending limits which are likely to be used as a result of this merger would affect only a small number of businesses which have other sources available for loans over $1 million.[3]

[3] State banks in Tennessee have a lending limit equal to 25% of capital funds, but Valley Fidelity limits its loans, except on rare occasions, to 15% of capital funds, as a matter of prudence. The 15% limitation amounts today to approximately $900,000 and is increasing each year by $50,000 or more as earnings are retained. Fifteen percent of Bank of Knoxville's capital funds would add

he benefits claimed, the ones most likely to affect "all
ers of banking services in the community" are those
ting to the immediate expansion of Valley Fidelity's
tgage servicing department and its branch system. As
he first, the funds for the proposed expansion can be
to be available within Valley Fidelity's present asset
cture. The importance, moreover, to the Knox County
lic of a $4 million increase in Valley Fidelity's present
tgage servicing operation cannot properly be assessed
out definitive information, not presented by the Appli-
, as to the mortgage servicing operations of indepen-
brokers and savings and loan associations also operat-
in the Knox County area. As to the second benefit
med, both banks recognize the importance to their
re prospects of *de novo* branching and have expressed
r intention of pursuing such a course of action whether
ot the merger is approved. It is relevant here that
Corporation recently approved two *de novo* branch
lications in Knox County for Volunteer State Bank,
smallest competitor in the market and the one most
ntly established. It is also relevant to both claims of
munity benefit that the two banks are profitable and
-managed institutions: Valley Fidelity added more
$450,000 to capital funds after taxes and dividends in
, while Bank of Knoxville added more than $160,000
same year. Thus, by natural growth, Valley Fidelity,
ot Bank of Knoxville, should be able to provide the
ous benefits claimed to the Knox County public in the
future without the necessity for this merger.

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roximately $450,000 to Valley Fidelity's voluntary limit. The
ing limits of the two larger national banks in Knoxville are,
ectively, about $1.7 million and $1.1 million.

On the record, the Board cannot find that the anticompetitive effects of the proposed merger are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the banking public in Knox County.

Financial and Managerial Resources; Future Prospects. Both banks have satisfactory financial and managerial resources for the business they do as independent institutions, and both have satisfactory prospects for the future. The same would be true of the resulting bank if the merger were to be approved, but consideration of these factors adds no significant weight either to approval or denial of an application in which a violation of Section 7 of the Clayton Act has been found.

Based on the foregoing, the Board of Directors has concluded that approval of the application is not warranted and that it must, accordingly, be denied. [9/4/70]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: First-Citizens Bank & Trust Company
Smithfield, North Carolina
Application for Consent to Merge and Establish Three Branches and for Consent to the Retirement Provision of Preferred Stock

Basis for Corporation Denial

First-Citizens Bank & Trust Company, Smithfield, North Carolina ("Citizens"), an insured State nonmember bank with total deposits of $571,829,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to merge with The Lucama-Kenly Bank, Lucama, North

Carolina ("Lucama-Kenly"), an insured State nonmember bank with total deposits of $5,616,000. The banks would merge under the charter and title of Citizens and, as an incident to the merger, the three offices of Lucama-Kenly would become branches of Citizens, increasing the number of its offices to 148. Approval is also requested for the retirement provisions of preferred stock.

Competition. Citizens is the fourth largest bank in North Carolina, controlling 9.1 percent of total commercial bank deposits in the State (the first, second and third largest banks holding 20.7 percent, 17.0 percent and 13.6 percent of such deposits respectively). Citizens has branches widely distributed throughout the State, but most of its 145 offices are located in eastern North Carolina. Its main office and 9 branches are located in Johnston County (1970 estimated population: 60,477), it has a branch at Spring Hope in adjacent Nash County (1970 estimated population: 57,233) and is also represented in adjacent Wilson County (1970 estimated population: 57,328) where it has two branches at Wilson.

Lucama-Kenly has one office in each of these three counties: its main office at Lucama in Wilson County, a branch office at Bailey in Nash County and a branch office at Kenly in Johnston County. Each is a sparsely populated community served only by Lucama-Kenly, and there are no intervening banks between the three locations. The area served by Lucama-Kenly, however, is also partially served by Citizens' offices at Spring Hope, Wilson, Selma and Smithfield, by offices at Wilson of First Union National Bank of North Carolina (the State's third largest bank), by offices at Wilson, Micro and Selma of Branch Banking & Trust Company (the State's sixth largest bank), and by an office at Smithfield of First Na-

tional Bank of Smithfield. Citizens has the largest share of local deposits (an estimated 37 percent), Branch Banking & Trust Company the next largest share (an estimated 35 percent), and Lucama-Kenly the smallest share (an estimated 5 percent). Wilson is 8 miles from Lucama-Kenly's nearest office, Micro and Selma are 5 miles from Lucama-Kenly's nearest office, while Spring Hope is 16 miles north and Smithfield 16 miles south of Lucama-Kenly's nearest office.

With offices of Citizens surrounding the area served by Lucama-Kenly and also serving parts of the same area, the proposed merger would have the effect of eliminating existing competition between the two banks, reducing the number of alternatives in the vicinity of Lucama-Kenly's service area from five to four, and adding to the very high share of the local banking market already held by Citizens.

North Carolina law permits Statewide *de novo* branching, but the likelihood of competition arising between Citizens and Lucama-Kenly through increased *de novo* branching activity is remote. Lucama-Kenly has very limited resources for such *de novo* branching activities against the larger banks in the surrounding area, while Citizens is not likely to be attracted to Lucama, Kenly or Bailey because of their limited population and lack of growth potential. On the other hand, Lucama-Kenly has alternative merger possibilities available to it and a different merger might bring the resulting bank into significant competition with Citizens in Wilson, Johnston and Nash Counties as well as elsewhere in North Carolina.

In this regard, as was noted in approving the recent proposed merger of Citizens and The Haynes Bank, Cliffside,

North Carolina, the Corporation is keenly aware of recent developments in the commercial banking structure of North Carolina. Since year-end 1964, more than 43 banks in the State have merged out of existence, and a sizable number of these have merged with the five largest banks in the State. Those banks already hold 67.2 percent of all commercial bank deposits and 63 percent of all commercial bank offices in North Carolina. While most of Citizens' expansion during the past 6 years has been accomplished by *de novo* branching, it has acquired 3 small banks since year-end 1964. Generally speaking, adding to the resources of a bank the size of Citizens by merger encourages the further concentration of banking assets in the State, rather than the deconcentration of such assets which might occur through *de novo* branching or some alternative merger. For as the number of viable, independent banks remaining in the State decreases, opportunities for deconcentration, through the affiliation of such banks with other banks capable of challenging the larger banks in the State, become increasingly less numerous. Under these circumstances, the merger of significant local banks with any of the larger banks in the State should be approached with the most careful regulatory scrutiny, increasing in vigor with the size of the acquiring bank.

Here, Citizens seeks to merge with a bank having three offices in a general trade area where it already holds more than 37 percent of area deposits. As a consequence, the merger would bring no new source of competition to the area but instead would serve to entrench Citizens in an even more dominant position in the market than it has today. The precedent of approval, moreover, would encourage the largest banks in the State to seek similar mergers in areas they already serve and in which they, too,

have a significant portion of the market. A denial of the merger, on the other hand, would encourage Lucama-Kenly to seek out another merger partner, smaller than Citizens and not presently represented within convenient driving distance of its three offices. Such a merger might well produce the benefits in banking service claimed for this proposal, while also enlarging the public's choice of convenient banking alternatives.

Based on these facts, and in view of the large number of less anticompetitive mergers available to Lucama-Kenly, the Board of Directors is of the opinion that the effect of the proposed transaction may be substantially to lessen competition in Johnston, Wilson and Nash Counties and in North Carolina generally.

Convenience and Needs of the Community to be Served. The proposed merger would replace a small, independent bank offering limited services with branches of the fourth largest bank in North Carolina, offering a full range of banking and trust services. This increase in convenience would affect only limited numbers of customers, and is further reduced in importance by the proximity today of six branches of Citizens to Lucama-Kenly's three offices. Since these branches already offer the wider range of services, the more liberal credit policies and the more aggressive management that the proposed merger would bring to Lucama-Kenly's three offices, the Corporation considers the additional increment to community needs and convenience to be slight. They can, moreover, be achieved as readily by numerous other, less anticompetitive mergers.

Financial and Managerial Resources; Future Prospects. These factors are adequate with respect to both merging

banks and should be favorable for the resulting bank. They add, however, no decisive weight toward approval or denial of a proposed merger the effect of which may be substantially to lessen competition in a relevant market. A special examination of Lucama-Kenly concluded on December 11, 1970, moreover, disclosed no financial or management condition which might adversely affect the future prospects of that institution.

Based on the foregoing, the Board of Directors has concluded that approval of the proposed merger of Citizens and Lucama-Kenly is not warranted and should, accordingly, be denied. [1/4/71]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: First-Citizens Bank & Trust Company
Smithfield, North Carolina
Application for Consent to Merge and
Establish Three Branches and for Consent to
the Retirement Provision of Preferred Stock

Statement Upon Reconsideration

First-Citizens Bank & Trust Company, Smithfield, North Carolina ("Citizens"), an insured State nonmember bank with total deposits of $663,191,900, was denied on January 4, 1971, the Corporation's prior approval to merge with The Lucama-Kenly Bank, Lucama, North Carolina ("Lucama-Kenly"), an insured State nonmember bank with total deposits of $7,170,000. A copy of the Corporation's *Basis for Denial* of the original application is attached. Citizens then petitioned the Corporation to reconsider its original denial offering to divest any one of Lucama-Kenly's branches if necessary to obtain the Corporation's approval.

The Corporation's Board of Directors, having reconsidered the application in light of Citizens' petition and subsequent analysis reaffirms its original denial, with the following additional statement.

In its Petition for Reconsideration, Citizens takes the position that if the merger were approved competition would not be lessened in any primary area served by Lucama-Kenly's three offices nor in Johnston, Nash or Wilson Counties as a whole.

To support this conclusion, it suggests that consideration of the competitive impact of the proposed merger should be limited to very narrow geographic areas surrounding each Lucama-Kenly office and then finds that Citizens has practically no deposit accounts and insignificant loan business from any of those areas. It also stresses the fact that each county has more commercial banks and more commercial bank offices for its residents than the average for North Carolina or the United States.

The Corporation agrees with Citizens that not all of Johnston, Wilson and Nash Counties can properly be considered in assessing the competitive impact of a merger between Citizens and Lucama-Kenly since many bank offices in all three Counties are quite remote from Lucama-Kenly's three offices and cannot reasonably be considered in competition with them.[1] The Corporation does not agree, however, that the competitive impact of the proposed merger should be assessed only within the narrowly circumscribed areas suggested by Citizens.

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[1] The Corporation frequently uses county-wide deposit totals to approximate a market because of the convenient availability of such data in its biennial Summary of Deposits, most recently published as of June 30, 1970.

ıe residents and businessmen of Johnston, Wilson and ash Counties who will be affected by the proposed merger e those for whom any one of the three offices of Lucama-enly are convenient alternatives to other offices for the ınking services they need or desire. Given the semi-rural ıture of the countryside around each Lucama-Kenly office, e general reliance of the public on automobile travel r transportation, and the existence of well-paved roads, eluding a major U. S. route that links Lucama and Kenly th Smithfield on the south and Wilson on the north, the orporation considers it not unreasonable to consider all mmercial bank offices within approximately 15 miles of y Lucama-Kenly office as offering competition to that nk.

ithin 15 miles of these offices, there are 42 commercial nk offices today holding about $135 million in IPC de-sits. Nine different banks have offices in this area, but ree hold more than 86 percent of area deposits: Citizens ith 11 offices and 33 percent of area deposits), Branch anking & Trust Company (with 14 offices and 29 percent total area deposits) and First Union National Bank of orth Carolina (with six offices and 24 percent of total ea deposits). Lucama-Kenly is the only remaining inde-endent bank of consequence between Smithfield, Selma d Micro to the south and Wilson to the north. In the rmer locations, Citizens and Branch Banking & Trust ompany both conduct significant branch operations; in ilson, all three of the dominant area banks have signifi-nt branch operations. And for some area residents near ucama-Kenly's office in Bailey, Wilson on the east might the more obvious choice for alternative sources of com-ercial bank service than Middlesex, Zebulon or Wendell the west. The proposed merger would add Lucama-enly's 4 percent to Citizens' present share of local area

deposits and reduce by one the limited number of commercial bank alternatives available to any particular customer or potential customer of Lucama-Kenly.

The Board reiterates its general concern that the proposed merger, because it involves an acquisition in an area where Citizens is already well represented, would provide an undesirable precedent in the long-run for the commercial bank structure of the State of North Carolina, where an evident merger trend has significantly increased the share of Statewide commercial bank deposits held by the five largest banks in the State since 1964. Even conceding that a more accurate percentage figure would be 33 percent rather than 37 percent, the Board finds no reason to revise its earlier conclusion that:

> "Here, Citizens seeks to merge with a bank having three offices in a general trade area where it already holds more than 37 percent of area deposits. As a consequence, the merger would bring no new source of competition to the area but instead would serve to entrench Citizens in an even more dominant position in the market than it has today. The precedent of approval, moreover, would encourage the largest banks in the State to seek similar mergers in areas they already serve and in which they, too, have a significant portion of the market. A denial of the merger, on the other hand, would encourage Lucama-Kenly to seek out another merger partner, smaller than Citizens and not presently represented within convenient driving distance of its three offices. Such a merger might well produce the benefits in banking service claimed for this proposal, while also enlarging the public's choice of convenient banking alternatives.

"Based on these facts, and in view of the large number of less anti-competitive mergers available to Lucama-Kenly, the Board of Directors is of the opinion that the effect of the proposed transaction may be substantially to lessen competition in Johnston, Wilson and Nash Counties and in North Carolina generally." •

sed on the foregoing, and on its review of the banking tors and the convenience and needs of the community be served, the Board concludes again that approval of proposed merger of Citizens and Lucama-Kenly is not rranted and should, accordingly, be denied. [7/12/71]

EDERAL DEPOSIT INSURANCE CORPORATION

Re: Westminster Trust Company
Westminster, Maryland
Application for Consent to Merge
and Establish Four Branches

BASIS FOR CORPORATION DENIAL

estminster Trust Company, Westminster, Maryland rust Company), a State nonmember insured bank with al resources of $18,390,000, has applied, pursuant to Sec- n 18(c) and other provisions of the Federal Deposit In- rance Act, for the Corporation's prior consent to merge

• Because the Corporation's original decision discounted the elihood of competition arising between Citizens and Lucama- nly through increased *de novo* branching, the Board considers lower-than-average population per commercial bank office which ts in Johnston, Wilson and Nash Counties to be irrelevant to reconsideration of the application. Moreover, since regulatory icy is or should be directed toward the deconcentration of highly centrated local banking markets, the fact that Citizens' share total deposits in the three-county area has shown a modest cline since 1966 provides no affirmative basis for reversing the rporation's earlier decision.

with The Union National Bank of Westminster, Westminster, Maryland (Union Bank), with total resources of $14,596,000, under the charter of Trust Company and with the title of Northern Maryland Bank and Trust Company.[1] The four offices of Union Bank would become branches of the resulting bank increasing the number of its offices to eight.

Competition. The proposed merger would consolidate the second and third ranking banks presently headquartered in Westminster, Maryland (1970 population 7,143). Trust Company operates two offices there, one in Union Mills, seven miles northwest of Westminster and one in Winfield, twelve miles southwest of Westminster. Union Bank operates two offices in downtown Westminster, one in a shopping center on the outskirts of Westminster and one in Finksburg, eight miles southeast of Westminster. The two banks are substantially smaller than the largest bank presently operating in Westminster, Carroll County Bank and Trust Company, a $45 million deposit institution.

The offices of Trust Company and Union Bank are all located in Carroll County (1970 population 68,329), which is in the north central sector of Maryland adjacent to the Pennsylvania State line. The rural orientation of Carroll County is being replaced by emphasis on light manufacturing, retail and wholesale trade and services. Farm operations, following a general trend, are being consolidated with consequent increase in the size of the average farm and its capital requirements. Although Carroll County is on the outer fringe of the Baltimore SMSA and some commutation to other parts of the SMSA occurs, the proposed merger would have its greatest public impact in Carroll County and in the adjacent communities of Reisterstown and Glyndon,

[1] Figures as of June 30, 1970.

th of which are in Baltimore County but easily accessible Westminster by divided highway. Both banks draw eir deposit and loan business almost exclusively from this ea. Both banks, headquartered in Westminster, the unty seat and geographic center of Carroll County, have ices in communities easily accessible to Westminster, and ere appears to be only limited economic interaction be- een the people in this market area and the rest of the ltimore SMSA or the York (Pennsylvania) SMSA to north.

e close identity of service areas for Trust Company and ion Bank emphasizes that their proposed merger would minate direct competition between them, and the figures dicate this competition is relatively substantial and sig- icant. Union Bank has a somewhat larger total of public posits than Trust Company, but except for this difference eir deposit structures are similar. More than one-half of ion Bank's deposits, moreover, are derived from cus- ners who also deposit at Trust Company. Half of each nk's loan portfolio is in real estate loans, and both banks approximately the same volume of installment lending the area.

e proposed merger would not only eliminate this existing mpetition but also the possibility, thro gh *de novo* branch- g, of increased competition between the two banks in the ture. Both have been successful in opening *de novo* anches in Carroll County in the past, and population ends in the County and in Reisterstown and Glyndon make rther *de novo* branching likely in the future.

welve commercial banks have offices in the designated arket area, with Trust Company holding 12.2 percent of tal IPC deposits and Union Bank 9.0 percent. Their pro-

posed merger would create a bank holding 21.2 percent of the market, exceeded only by Carroll County Bank and Trust Company with 33.7 percent of the area's total IPC deposits. None of the other nine banks would have more than 9.8 percent of the area's total IPC deposits. Approval of the proposed merger would thus add significantly to commercial bank concentration in the relevant geographic market and encourage other direct competitors to merge.

Furthermore, although twelve commercial banks have offices in the relevant geographic market, approximately 50 percent of area IPC deposits are held at the Westminster offices of Carroll County Bank and Trust Company, Westminster Trust Company and Union Bank. By contrast, only one-tenth of the area's population lives there. This emphasizes Westminster's role as the economic as well as geographic center of the market and indicates further that many area residents turn to Westminster for banking services which are not provided by the smaller institutions elsewhere in the market. For this reason, a disproportionately large segment of the public living in the market area would be affected by the proposed reduction from three to two in the number of banking alternatives in Westminster.

Based on the foregoing and on applicable judicial precedents, the Board of Directors is of the opinion that the effect of the proposed merger would be substantially to lessen existing and potential competition in commercial banking in Carroll County, Reisterstown and Glyndon.

Convenience and Needs of the Community to be Served. If the proposed merger were approved, the only immediate change in services to the public would be an increase in lending limits from $90,000 in the case of Trust Company and $70,000 in the case of Union Bank to $172,000. With

ne exception, neither bank has originated any loan within ne past year which has been shared with any other bank nd it appears that only a very small number of business ustomers would benefit from the higher lending limit. The pplication further states that it is not anticipated that any ew services would initially be offered by the resulting ank.

he Board of Directors, accordingly, cannot find that the nticompetitive effects of the proposed transaction would e clearly outweighed in the public interest by the probable ffect of the transaction in meeting the convenience and eeds of the banking public in the relevant geographic mar-et.

inancial and Managerial Resources; Future Prospects. ach of the participating banks has adequate financial re-ources, with Union Bank's recent earnings performance omewhat more impressive than Trust Company's. Union ank anticipates a management succession problem in the ext few years, but there are alternatives available to the roposed merger for the resolution of what is presently nly a potential problem. The future prospects of both anks, in a growing market, are favorable.

ased on the foregoing, the Board of Directors has con-luded that approval of the application is not warranted nd that it must, accordingly, be denied. [5/14/71]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Anderson Banking Company
Anderson, Indiana
Application for Consent to Merge
and Establish One Branch

Basis for Corporation Denial

Anderson Banking Company, Anderson, Indiana (Applicant), an insured State nonmember bank with total deposits of $60,076,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to merge with The State Bank of Lapel, Lapel, Indiana (Lapel Bank), an insured State nonmember bank which has total deposits of $3,405,000. The banks would merge under the charter and title of Applicant and as an incident to the merger the one office of Lapel Bank would become a branch of the resulting bank increasing the number of its offices to nine.

Competition. The eight offices of Applicant are all in Madison County which, with small portions of contiguous counties, constitutes its primary trade area. Anderson, the county seat of Madison County, is a highly industrialized city located in the east central section of the State of Indiana, between Indianopolis, 35 miles to the southwest,. and Muncie, 18 miles to the northeast. In the ten years prior to 1970, the population of Madison County increased from 125,819 to 137,451.

Lapel Bank's sole office is in the town of Lapel (population 1,725), about 11 miles southwest of Anderson near the Madison County-Hamilton County border. Lapel serves as a trading center for nearby farmers. A sizable number of area residents commute to Anderson to work in the industrial plants located there.

plicant is the largest, and Lapel Bank the smallest com-
rcial bank in Madison County, with 39.7 percent and 2.1
rcent, respectively, of total IPC deposits held by Madison
unty commercial banks. Applicant and the two next
gest banks in the County together hold some 75 percent
total IPC deposits. Some Madison County banks, how-
er, such as those in Alexandria and Summitville, are not
dily accessible to Lapel area residents, while commer-
l banks in Noblesville (nine miles to the west of Lapel in
milton County) and Fortville (eight miles to the south of
pel in Hancock County) are. After making these adjust-
nts to local area deposits, Applicant alone would hold
out 30 percent of the resulting market, and together with
e American National Bank of Noblesville and Citizens
nking Company, Anderson, the second and third ranking
nks, respectively, in the same market, would hold 67 per-
t of such deposits. The proposed merger would thus add
the strength of the dominant local bank, increase the con-
tration of banking resources in an already highly concen-
ted market, reduce by one the number of alternative
rces of commercial bank services conveniently available
Lapel area residents, and eliminate direct competition
tween Applicant and Lapel Bank for the banking busi-
ss of those area residents who commute to Anderson to
rk.

der relevant Indiana law, which permits *de novo* branch-
for Madison County banks only within Madison County
d subject to home office protection, Applicant could not
ter Lapel by *de novo* branching at the present time. Ap-
cant could enter unincorporated areas near Lapel, but
s may be relatively unattractive in view of their sparse
pulation. Were Lapel Bank to merge with one of the

other seven Madison County banks, however, home office protection would be removed from Lapel, and Applicant has indicated it would, in that event, be likely to seek a *de novo* branch within the incorporated areas of Lapel. Consummation of the proposed merger would eliminate that potential for increased competition between the two banks in the future.

In view of Applicant's present 30 percent share of the relevant deposit market, its dominant position in Madison County as a whole, the highly concentrated nature of commercial banking in the relevant market and in Madison County as a whole, the elimination of both present and potential competition if this merger is approved, and the availability to Lapel Bank of other alternatives if this merger is denied, the Board of Directors is of the opinion that the effect of the proposed transaction may be to lessen competition substantially within the relevant market and within Madison County as a whole.

Convenience and Needs of the Community to be Served. The proposed merger would replace a small, limited service bank with an office of a larger bank offering a higher lending limit and certain lending and deposit services not now available at Lapel Bank. Such services are available, with only slight inconvenience, however, from banks in Noblesville, Pendleton and Anderson, including Applicant. Thus, the proposed merger would have only slight impact on the convenience and needs of the community to be served.

Financial and Managerial Resources; Future Prospects. Both banks have adequate financial and managerial resources, although Lapel Bank has permitted a management succession problem to arise. The stock of Lapel Bank is closely held, however, and it is one of the most profitable

Madison County banks. The record indicates that Lapel Bank is likely to have other solutions to its management succession problem even if the proposed merger with Applicant is denied.

Since the anticompetitive effects of the proposed merger are not clearly outweighed by the convenience and needs of the community to be served, the Board of Directors has concluded that the proposed merger of Applicant and Lapel Bank should be denied. [7/19/71]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: The Citizens and Southern Emory Bank
Atlanta, Georgia
Application for Consent to Acquisition of Assets and Assumption of Liability to Pay Deposits and to Establish Two Branches

Basis for Corporation Denial

The Citizens and Southern Emory Bank, Atlanta, Georgia (Emory Bank), an insured State nonmember bank with total deposits of $34,796,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to acquire the assets of and to assume the liability to pay deposits made in Citizens and Southern Bank of Tucker, Tucker, Georgia (Tucker Bank), an insured State nonmember bank with total deposits of $24,738,000.[1] Application is made also under Section 18(d) of the Federal Deposit Insurance Act to operate the main and single branch office of Tucker Bank as branches of the resulting bank.

[1] Deposit data as of June 30, 1971.

Competition. The Citizens and Southern National Bank (C&S National), Savannah, Georgia, is the owner of all the outstanding stock of Citizens and Southern Holding Company (C&S Holding), Savannah, Georgia, which in turn owns 95.14 percent of the stock of Emory Bank and 5.0 percent of the stock of Tucker Bank.

The C&S system, including its 5% affiliates, presently controls 41.8 percent of all deposits held at DeKalb County commercial bank offices and 25.4 percent of all commercial bank offices in the County, making it by far the largest banking system in DeKalb County.

Tucker Bank was organized in 1919 and did not become affiliated with the C&S system until early 1965. At that time Tucker Bank maintained only one office, holding approximately $4 million in deposits.

When C&S Holding acquired its 5% interest in Tucker Bank, approximately 75 percent of Tucker Bank's remaining stock was acquired simultaneously by holders close to the C&S system. Ever since, Tucker Bank has been operated with substantially the same close working relationship between it and other C&S banks that exists between the C&S system and the 5% banks which it organized *de novo*. This relationship, and the lack of existing competition between C&S banks, are detailed in the Basis for Corporation Approval issued this date in connection with the proposed acquisition by the Citizens and Southern Bank of East Point and two other 5% C&S banks in Fulton County.

Even as to Tucker Bank, the Corporation sees no reason to anticipate a voluntary disaffiliation from the C&S system if this proposed merger is denied.

The close, and apparently friendly, working relationship that presently exists with the C&S system argues against the likelihood of such disaffiliation despite the fact that 7 percent of the outstanding stock of Tucker Bank remains in the hands of the family that controlled the bank as an independent institution when C&S acquired its interest in 1965. As in the case of the other proposed mergers of 5% banks into majority-owned C&S subsidiaries, more than 87 percent of the outstanding shares of Tucker Bank were voted in favor of this proposed merger and only 26 shares (less than 0.1 percent) of the outstanding shares were voted against the proposal. Disaffiliation, if it occurs, would appear to depend on compulsory process to sever the C&S relationship with this bank, rather than the denial of the application now before the Corporation.

While the Corporation finds that existing competition would not be eliminated by the proposed merger, and that future competition through voluntary disaffiliation is unlikely, it subscribes to the following view expressed by the Board of Governors of the Federal Reserve System in its May 20, 1971, opinion on the reconsideration of its earlier decision relating to the proposed merger of Trust Company of Georgia and Peachtree Bank and Trust Company, Chamblee, Georgia:

> "... A merger of two banks which are not significant competitors cannot be regarded as eliminating significant existing competition, and, similarly, if future competition is unlikely—even though possible—the merger cannot be regarded as reasonably likely to lessen future competition.
>
> "This does not mean that every proposed merger before the Board of two related banks receives favorable

consideration. *First of all, consideration must be given to the question of whether the relationship was anti-competitive in its origins; if so, little weight should be attributed to such relationship, since to do so might encourage evasion of the law.* * * *" [Emphasis supplied.]

The Corporation took a similar position in its December 1, 1970, opinion approving the proposed merger of The Lone Tree Savings Bank into The Farmers and Merchants Savings Bank, also of Lone Tree, Iowa, and in its December 4, 1970, opinion approving the proposed merger of Embarrass State Bank, Embarrass, Wisconsin into Citizens State Bank, Shawano, Wisconsin.

The following circumstances surrounding the affiliation of Tucker Bank with the C&S system in 1965 appear relevant. Tucker Bank was a small, limited service unit bank serving primarily the credit needs of outside business interests of the Cofer family, its controlling owners. A new national bank was being organized in Tucker, which promised more intense competition. Seeking more experienced banking management and a good price for their stock, the controlling owners of Tucker Bank approached C&S National, with whose management they were personally friendly, and the sale of 80 percent of their stock to C&S interests was consummated shortly thereafter.

While the C&S affiliation resulted in broadening the banking services offered to Tucker Bank customers, it also resulted in a significant increase in the share of DeKalb County banking resources controlled by the C&S system. At year-end 1964, the C&S system already controlled approximately 24 percent of total DeKalb County commer-

l bank deposits and a slightly larger share of all the mmercial bank offices in the County. Tucker Bank's de-sits represented at that time about 5 percent of total eKalb County commercial bank deposits. Its affiliation th the C&S system not only increased substantially that stem's lead over other banking organization in the unty, but foreclosed the possibility that Tucker Bank, her as an independent bank under different control or part of another large banking organization with a less bstantial share of DeKalb County banking resources, uld become a significant competitor to the C&S system.

cker Bank at the time was not in an unsound condition, had had no experience actually competing against the w bank being organized in its community, and the rec-d discloses no serious effort on the part of its owners find some other, less anticompetitive solution to the new uation it faced. Moreover, with the growth projected for e Tucker area, the C&S system might have found it sirable and practicable, if not in 1964-1965, then at some ter date, to establish a *de novo* bank in the area served by cker Bank, just as it did in other growing sections of eKalb County prior to the recent change in Georgia's anching laws.

ased on the increased concentration of DeKalb County nking resources in the C&S system and the elimination probable future competition with Bank of Tucker had e affiliation with C&S not taken place, the Corporation ds that the present affiliation was anticompetitive in its igins and should not now be ratified by the Corporation's pproval under the Bank Merger Act.

inancial and Managerial Resources; Future Prospects. hese factors are satisfactory with respect to each of the nks involved and are so projected for the resulting bank.

Convenience and Needs of the Community to be Served. In view of the close working relationship that presently exists between the C&S system and these two banks, neither consummation nor denial of the proposed merger would change in any significant way the ability of Tucker Bank to serve the convenience and needs of DeKalb County residents.

With the various other factors to be considered weighing neither for approval nor denial, the Corporation concludes that the application now before it should be denied in view of the anticompetitive nature of the original affiliation of Bank of Tucker with the C&S system in 1965. [10/4/71]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Continental Bank
Norristown, Pennsylvania
Application for Consent to Merge and
Establish Twenty-two Branches

Basis for Corporation Denial

Continental Bank, Norristown, Pennsylvania ("Continental"), a State nonmember insured bank with total resources of $717,597,000 and total deposits of $620,966,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior consent to merge with Bank of Pennsylvania, Reading, Pennsylvania, with total resources of $252,416,000 and total deposits of $220,289,000.[1] The banks would merge

[1] Figures as of June 30, 1971. Deposit percentages as of June 30, 1970.

under the charter and title of Continental and, as an incident to the merger, the 22 offices of Bank of Pennsylvania would become branches of the resulting bank, increasing the number of its offices to 72.

Competition. Continental presently operates 50 offices in the Philadelphia SMSA, 20 of which are located in Philadelphia (population 1,948,609, down 2.7 percent since 1960), 16 of which are located in Montgomery County (population 623,799, up 20.7 percent since 1960), 6 of which are located in Bucks County (population 415,056, up 34.5 percent since 1960), 3 of which are located in Delaware County (population 600,035, up 8.5 percent since 1960), and 5 of which are located in Chester County (population 278,311, up 32.2 percent since 1960). Within this five-county area, Continental holds approximately 5.9 percent of all commercial bank deposits and 9.0 percent of all commercial bank offices, ranking sixth with regard to the total deposits held at commercial bank offices in these five counties and fifth with regard to the number of commercial bank offices within such counties. Continental's main office is in Montgomery County, but it has no office in the two remaining counties open to it under Pennsylvania law (i.e., Berks and Lehigh).

Bank of Pennsylvania operates 22 offices, 19 of which are located in Berks County (population 296,382, up 7.6 percent since 1960) and 3 of which are located in Lehigh County (population 255,304, up 12.2 percent since 1960). Fourteen banks have a total of 56 offices in Berks County, but only three banks are of substantial size: American Bank & Trust Company, headquartered in Reading, a $679 million institution, National Central Bank, headquartered in Lancaster, a $627 million institution that recently merged with Reading Trust Company, and Bank of Pennsylvania. Al-

though third largest in total resources, Bank of Pennsylvania ranks second in terms of Berks County deposits, with 26.1 percent of total IPC deposits held at offices within the county. In Lehigh County, where Bank of Pennsylvania has opened two *de novo* offices since 1968, it holds only 2.2 percent of total IPC deposits held at offices within the county and competes with eleven other banks, six of which exceed $100 million in total assets. In the combined two-county area, Bank of Pennsylvania holds 15.9 percent of total IPC deposits, ranking third in this regard in the Berks-Lehigh banking market. Under Pennsylvania law, Bank of Pennsylvania has the right to branch *de novo* or merge in several other counties where it has no offices today —i.e., Montgomery, Chester, Lancaster, Lebanon and Schuylkill. If the proposed merger is approved, the resulting bank would lose the legal authority to enter Lancaster, Lebanon and Schuylkill Counties.

The closest offices of the two banks—Continental's Pottstown Branch in Montgomery County and Bank of Pennsylvania's Boyertown Branch in Berks County—are eight miles apart, but the immediate areas served by each bank are quite distinct. While there are a number of common depositors, approximately fifteen are major national firms or utilities doing business throughout this section of Pennsylvania. Neither bank draws more than a small amount of deposit, loan or trust business from areas presently served by the other, and their proposed merger would not eliminate any significant existing competition between them.

The proposed merger, on the other hand, would eliminate the possibility of increased competition between the two banks in the future and adversely affect future competition

in a number of counties in this general section of Pennsylvania.

Since 1965, most of the major Philadelphia banks, including Continental, have moved their main offices to Montgomery County so as to extend the geographic reach of their branch systems to Lehigh, Berks and Chester Counties as permitted by Pennsylvania law. Continental itself now has five offices in fast-growing Chester County, where income levels are substantially above Statewide averages and the population per commercial bank office is 6,325. Lehigh County similarly is a growing county, with above average income levels and a population per commercial bank office of approximately 5,800. Berks County has only average income levels and a somewhat lower population per commercial bank office than Lehigh (i.e., 5,489 persons), but it, too, has been growing substantially in population and additional *de novo* branching appears likely. While Continental is not the largest Philadelphia bank able to enter Berks and Lehigh Counties *de novo*, it is clearly one of the most likely entrants in view of its aggressive efforts in the past to expand by both *de novo* branching and by merger into counties where it was not already represented.

Commercial banking resources are already highly concentrated in both Berks and Lehigh Counties. American Bank & Trust Company, National Central Bank and Bank of Pennsylvania together hold 82.4 percent of all Berks County commercial bank deposits, while the three principal banks in Lehigh County hold 84.5 percent of its total commercial bank deposits. If the deconcentration of banking resources and greater public choice among alternative sources of banking service are to be encouraged, *de novo*

entry by significant banks not presently represented in either county, or their entry by merger with much smaller local banks than Bank of Pennsylvania, is clearly preferable to a transaction in which one of the most likely entrants seeks to acquire a bank with a market share as large as that which Bank of Pennsylvania currently holds in Berks County.

The proposed transaction would adversely affect future competition in other counties as well. Bank of Pennsylvania, a $252 million institution, now has legal capacity to expand *de novo* or by merger into five counties in addition to Berks and Lehigh.

Continental has a significant share of the local deposit market in two of these counties (Montgomery and Chester), and both are among the fastest growing counties in Pennsylvania, with income levels well above the Statewide average. In the absence of merger, greater competition between Bank of Pennsylvania and Continental in these two counties would be increasingly likely as Bank of Pennsylvania seeks additional ways to expand outside its headquarters county. Bank of Pennsylvania, it should be noted, has opened six *de novo* branches since 1968, and has had successful experience in branch operations. The proposed merger would eliminate this additional potential for increased competition between the two banks.

Bank of Pennsylvania, moreover, would lose the legal capacity to expand *de novo* or by merger into Lancaster, Lebanon and Schuylkill Counties if the proposed merger is approved. Based on population trends, income levels and the present number of commercial bank offices, Lancaster County (population 319,693, up 14.8 percent since 1960) must be considered the most attractive, and Lebanon

County the next most attractive, of the three counties for expansionary moves today by outside banks. Bank of Pennsylvania, as the largest such outside bank with capacity to enter and with successful branching experience, is the most likely potential entrant into both counties, but such entry would no longer be possible if the proposed merger is approved.

The Board of Directors has concluded, accordingly, that approval of the proposed merger would eliminate a significant potential for greater competition between Bank of Pennsylvania and Continental Bank in Berks, Lehigh, Chester and Montgomery Counties and would adversely affect future commercial bank competition in Lancaster and Lebanon Counties. Since Bank of Pennsylvania and Continental are both effective competitors in the banking markets they serve today, the Board of Directors has further concluded that the competitive factors presented by the application weigh against approval despite the fact that significant existing competition between the two banks would not be eliminated.

Convenience and Needs of the Community to be Served. Approval of the proposed merger would have no appreciable effect on present or potential customers of Continental, but it would increase the unsecured lending limit available to Bank of Pennsylvania customers from $1.7 million to $7 million and make available to them a number of specialized services presently offered by Continental, but not by Bank of Pennsylvania. The demand in Berks County for such services and for loans above $1.7 million is limited, however, and no claim is made that any essential banking needs are going unmet today. What demand there is for these specialized services can apparently be

satisfied today by the two larger banks with offices in Reading or by the Philadelphia banks with offices in nearby Montgomery County. Continental, moreover, can introduce another local source for such services by branching *de novo* into Reading without the anti-competitive consequences of the proposed merger.

With $252 million in assets, Bank of Pennsylvania should be quite capable of meeting the normal banking requirements of the vast majority of its customers. These retail customers would experience little apparent benefit from the proposed merger and could, in fact, be adversely affected if Continental extended to them its significantly higher service charges on nonbusiness checking accounts. Considerations of convenience and need, therefore, would appear to weigh neither significantly for, nor significantly against, approval of the proposed merger.

Financial and Managerial Resources; Future Prospects. Both banks have satisfactory financial and managerial resources for the business they do as independent institutions, and both have satisfactory prospects for the future. The same would be true of the resulting bank if the merger were to be approved. While three of Bank of Pennsylvania's top four officers plan to retire during calendar 1972, it is the Corporation's view that qualified replacements are readily available to the bank, either by promotion from within or by outside recruitment.

Inasmuch as the anticompetitive effects of the proposed merger are not, in the opinion of the Board of Directors, outweighed by any other factors, the Corporation has concluded that the proposed merger of Continental and Bank of Pennsylvania should be denied. [12/22/71]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Bank of Hawaii
Honolulu, Hawaii
Application for Consent to Merge
and Exercise Trust Powers

Basis for Corporation Denial

Bank of Hawaii, Honolulu, Hawaii, an insured, nonmember, commercial bank, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior consent to merge with Hawaiian Trust Company, Limited, Honolulu, Hawaii (Trustco), a non-insured institution, under the charter and title of Bank of Hawaii.

Competition. Bank of Hawaii is the largest commercial bank in the State of Hawaii, with total deposits of $572 million, representing about 38 percent of commercial bank deposits Statewide. It has 58 authorized offices at locations throughout the Hawaiian Islands and eight other offices on various Pacific islands to the west. It has no trust department, although a State law enacted in 1965 permits commercial banks to exercise fiduciary powers and to merge with State-chartered trust companies.

There are only six other commercial banks in Hawaii, and the largest of these is First Hawaiian Bank, with total deposits of $495 million, representing about 32 percent of commercial bank deposits Statewide. The five remaining commercial banks range in deposit size from $71 to $112 million, representing 4.6 to 7.4 percent of total Statewide commercial bank deposits.

In November 1969, a consent decree terminated antitrust action filed in 1966 to enjoin First Hawaiian Bank's merger

with Cooke Trust Company, Limited. At the time of its merger, Cooke Trust Company was the third largest State-chartered trust company administering about 10 percent of the total trust assets of all such fiduciaries. One other commercial bank, American Security Bank, with total deposits of $112 million, recently established a trust department *de novo,* but its fiduciary activities have so far been limited to acting as custodian for corporate pension and profit-sharing plans.

Trustco is the largest of three independent State-chartered trust companies in Hawaii, administering trust assets valued at approximately $1 billion. It is estimated that Trustco controls some 50 percent of the total corporate fiduciary business in Hawaii. Bishop Trust Company, Ltd. is the second-ranking trust company, controlling some 35 percent of the total corporate fiduciary business in Hawaii, including the trust assets administered by a wholly-owned affiliate located in Hilo. Honolulu Trust Company, Ltd., the remaining State-chartered trust company holds a relatively insignificant portion of the corporate fiduciary business in Hawaii. Trustco's main office is in Honolulu on the island of Oahu, and a recently opened branch is located in Hilo on the island of Hawaii.

Since Bank of Hawaii does not operate a trust department, and since Trustco does not conduct a general commercial banking business, the only area of competitive overlap today involves local lending where Trustco's share of the total would be relatively small. Accordingly, the amount of existing competition between Bank of Hawaii and Trustco which would be eliminated by their proposed merger may be deemed not significant.

Consummation of the proposed merger, however, would eliminate the possibility of future competition between the largest commercial bank in Hawaii and the largest trust company in Hawaii. Under the State law enacted in 1965, Bank of Hawaii can enter the fiduciary field *de novo* as well as by merger. Trustco, for its part, can enter the commercial banking field by merger with a much smaller commercial bank or by merger with a *de novo* commercial bank. A merger between these two institutions is obviously not required to permit Bank of Hawaii to exercise fiduciary powers or to permit Trustco to engage in commercial banking activities.

The Corporation recognizes that the establishment of a *de novo* trust department by Bank of Hawaii is likely to involve initial operating losses, a major effort to recruit qualified personnel, and a period of years to generate the fiduciary business necessary to make its activities in this area profitable. Smaller banks than Bank of Hawaii have successfully done so, however, and achieved profitable operations within a reasonable period of time. Bank of Hawaii, moreover, would start with certain advantages smaller banks might not have. Its financial and management resources, including investment skills, are obvious advantages, but more importantly, its influential customer relationships in the commercial banking field should help significantly to attract the large fiduciary accounts that most consistently make a trust department operation profitable. Bank of Hawaii, furthermore, is likely to have considerable incentive to enter the trust area, as indeed this application confirms. Its principal commercial bank competitor recently acquired a much smaller and less profitable trust operation than Trustco's. With proper management, successful trust department operations may add not

only to the bank's profits but also to the bank's commercial banking business. Conversely, the absence of a trust department, when competitors have them, may in time inhibit the growth of Bank of Hawaii's commercial banking business. All of these considerations mark Bank of Hawaii as the one commercial bank most able and most likely to enter the trust field *de novo.*

In view of the concentrated nature of the commercial banking business in Hawaii and the even more concentrated nature of corporate fiduciary activities in the State, the Corporation believes Bank of Hawaii should be required to enter the trust business on a *de novo* basis, if it is to enter the field at all. The State has only two large commercial banks and two large trust operations. In both fields, the two largest institutions control 70 percent or more of the total business. There are, in addition, significant stockholdings by each of the two largest trust companies in each of the two largest commercial banks and a significant number of director interlocks and common stockholdings which intensify regulatory concern over the concentration of commercial banking and corporate fiduciary business in the State of Hawaii. Approval of the proposed merger would foreclose the substantial probability of increased competition in both fields, since Bank of Hawaii, as previously stated, is the one commercial bank in the State most able and most likely to enter the corporate trust field *de novo,* while Trustco is the corporate fiduciary most able to contribute significant new business to one of the smaller commercial banks or to enter the commercial banking field itself *de novo.* Approval of the proposed merger would serve also to perpetuate Bank of Hawaii's dominant position in commercial banking in Hawaii, and the dominant position of its trust department,

acquired from Trusteo, in the corporate fiduciary field. Finally, smaller commercial banks would have only one independent trust company of significant size remaining to which to refer the trust business of their customers.

While the immediate extension of trust services through bank of Hawaii's branch system would be convenient to at least some potential users of trust services and would enhance competition in this field with First Hawaiian Bank, the Corporation believes that the longer-term effect of the proposed merger "may be substantially to lessen competition" in both commercial banking and the corporate fiduciary business in the State of Hawaii, to restrict the public's choice of alternative sources for both commercial banking and corporate fiduciary services, and to concentrate still further the banking and corporate fiduciary business in a market which is already highly concentrated.

Financial and Managerial Resources; Future Prospects. Both institutions are in sound financial condition, ably managed and profitable. Each has enjoyed substantial growth, and their future prospects are bright, irrespective of whether the proposed merger is consummated. While these factors would also be favorable for the resulting bank, they add no significant weight to a determination on the merits of the application.

Convenience and Needs of the Community to be Served. If the proposed merger is approved, users of trust services in Hawaii might find it convenient to transact their trust business through one of Bank of Hawaii's 58 branches located throughout the Islands, rather than being forced to transact such business at locations in Hilo or Honolulu. This convenience would be somewhat limited, at least initially, since Bank of Hawaii proposes to have its trust

officers travel back and forth to branch locations as needed, centralizing its actual trust operations at its principal offices in Honolulu and Hilo. These arrangements would be similar to those now available at branches of First Hawaiian Bank. Whatever increase in convenience trust customers would actually experience as a result of the proposed merger, however, could also be achieved by Bank of Hawaii's establishment of a trust department *de novo*.

Based on the foregoing, the Board of Directors has concluded that the anti-competitive effects of the proposed merger are not clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served and that the application of Bank of Hawaii should, accordingly, be denied. [12/18/70]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: United Mutual Savings Bank
Tacoma, Washington
Application for Consent to Merge
and Establish Five Branches

Basis for Corporation Denial

United Mutual Savings Bank, Tacoma, Washington (United Mutual), an insured mutual savings bank with total deposits of $65,541,000, has applied pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act for the Corporation's prior consent to merge with State Mutual Savings Bank, Tacoma, Washington (State Mutual), an insured mutual savings bank with total deposits of $31,071,000. The participants would merge under the charter of United Mutual and with the title of State United

tual Savings Bank. As an incident of the merger, the offices of State Mutual would become branches of the ulting bank, increasing the number of its offices to ten.

npetition. United Mutual and State Mutual are mutual ings banks headquartered in Tacoma, Washington. In ermining the competitive implications of their proposed ger for purposes of Section 7 of the Clayton Act, as orporated into the Bank Merger Act as amended, con- eration must first be given to a definition of the line ines of commerce within which they compete.

enever the United States Supreme Court has considered competitive implications of mergers between commer- banks, it has found that the *decisive* "line of commerce" such purposes is commercial banking because of the que "cluster" of services which commercial banks alone offer. It has rejected the claims of defendant banks t the various services offered by commercial banks uld be considered as constituting separate lines of com- ce in which other types of financial institutions and n nonfinancial organizations may also compete. The rt's most recent bank merger decision (*United States Phillipsburg National Bank,* decided June 29, 1970) re- med its earlier views on this point, but indicated that bmarkets" for commercial banking "would be clearly vant, for example, in analyzing the effect on competi- of a merger between a commercial bank and another e of financial institution."

the State of Washington, where mutual savings and n associations have the option to become mutual savings ks (State Mutual converted at the end of 1969), where n types of institutions may pay interest on deposits w $100,000 at the same rates and each at rates higher

than commercial banks, where at least some differential in interest rates has persisted between thrift institutions and commercial banks at almost all times throughout the post World War II period, where both types of institutions are identified by the public as thrift institutions engaged primarily in mortgage lending, where both by statute have very similar powers, privileges, restrictions and liabilities, it would appear that the *decisive* line of commerce for assessing the competitive implications of a proposed merger of mutual savings banks should be "thrift institution banking" as offered by savings banks and savings and loan associations. As indicated, in the State of Washington, savings banks and savings and loan associations are uniquely able to compete for deposits under $100,000 and are generally considered interchangeable alternatives for thrift-type deposits and for deposit institutions emphasizing home mortgage lending.

The geographic area within which the proposed merger would have its greatest competitive impact is Pierce County (the Tacoma SMSA). Each institution has four offices in Pierce County, and each derives the bulk of its deposit and loan business from the growing residential areas of Tacoma and Pierce County. The proposed merger would also have a competitive impact in Kitsap County, since each bank has a fifth office in Bremerton, the county's largest community, and the State as a whole must also be considered, because it is the widest area within which savings banks in Washington may branch or merge.

The main offices of the two banks are eight blocks apart in downtown Tacoma, and their eight offices in Pierce County represented one-third of the 24 offices of savings banks and savings and loan associations located in the

county at year-end 1969. United Mutual is the second largest of the 9 thrift institutions in the area, based on Pierce County deposits, and held approximately 20% of such deposits at year-end 1969. State Mutual is the fourth largest thrift institution in Pierce County, and held approximately 9.5% of the Pierce County deposits held by such institutions on the same date. While the largest thrift institution in Pierce County would be slightly larger than the resulting bank, the proposed merger would create a second-ranking thrift institution having almost 30% of the Pierce County deposits held by all such institutions.* The share of such deposits held by the two largest thrift institutions in Pierce County would be increased from 52.7% to 62.3%, and the share held by the three largest would be increased from 69.6% to 79.1%.

In Kitsap County, United Mutual and State Mutual each have one recently established office, located about three miles apart in Bremerton. They are the only savings banks with offices in the county, but they also compete with two savings and loan associations. The percentage share of thrift institution deposits which they hold in Kitsap County is small but growing.

While it is obvious that significant deposit competition presently existing between United Mutual and State Mutual would be eliminated by the proposed merger, the

* Even if the competitive deposit market, despite the differential in rates, were broadened to include the time and savings deposits held in Pierce County at commercial bank offices—an inclusion which would significantly understate the competitive position of United Mutual and State Mutual in the market for accounts below $100,000—the percentages held by each (10.9% and 5.2%, respectively) would still be sufficiently high to indicate a substantial lessening of competition for such accounts within the meaning of Section 7 of the Clayton Act.

transaction would also eliminate the possibility of greatly increased competition between them in the future. Both may open *de novo* branches anywhere in the State of Washington, and each has demonstrated in Pierce and Kitsap Counties its ability and success in opening branch offices in locations where vigorous deposit competition is presented.

Based on the foregoing, the Corporation finds that the effect of the proposed merger "may be substantially to lessen competition" between thrift institutions in Pierce County within the meaning of Section 7 of the Clayton Act, as incorporated into the relevant provisions of the Bank Merger Act of 1966.

Convenience and Needs of the Community to be Served. Both United Mutual and State Mutual offer "on line" computer service to depositors, although significant business is also done by mail. Both pay the maximum rates on savings deposits and certificate accounts allowed by FDIC regulations. Both are profitable, well-managed and growing institutions. The application states that the resulting bank would extend FHA and VA mortgage lending services to the present offices of State Mutual, and that additional resources could be committed to central city and urban renewal needs in the Tacoma area. FHA and VA mortgage loans, however, are available at many of the financial institutions in Pierce County, and there has been no demonstration that the overall demand for such loans is going unsatisfied. As to additional lending in central city and urban renewal areas, United Mutual should be able to supply the sums mentioned even without the proposed merger by marketing a portion of its FHA loans through the newly formed Savings Bank Trust Com-

pany-Northwest and through similar secondary market operations. Finally, while applicants claim that the merger would result in certain economies of scale, similar economies of scale could be realized for each bank through other, less anticompetitive, mergers among the State's 71 thrift institutions.

On the record, the Board cannot find that the anticompetitive effects of the proposed merger are clearly outweighed in the public interest by the possible effect of the transaction in meeting the convenience and needs of the banking public in Pierce County.

Financial and Managerial Resources; Future Prospects. Both banks have satisfactory financial and managerial resources for the business they do as independent institutions, and both have satisfactory prospects for the future. The same would be true of the resulting bank if the merger were to be approved, but consideration of these factors adds no significant weight either to approval or denial of an application in which the proposed merger appears to violate Section 7 of the Clayton Act.

Based on the foregoing, the Board of Directors has concluded that approval of the application is not warranted and that it must, accordingly, be denied. [10/5/70]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Washington Mutual Savings Bank
Seattle, Washington
Application for Consent to
Consolidate and Establish One
Branch

Basis for Corporation Denial

Washington Mutual Savings Bank, Seattle, Washington ("Washington Mutual"), an insured mutual savings bank with total deposits of $744,000,000, has applied, pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, for the Corporation's prior approval to consolidate with Grays Harbor Savings and Loan Association, Aberdeen, Washington ("S&L") which has total withdrawable balances of $4,700,000. The institutions would consolidate under the charter and title of Washington Mutual and the only office of S&L would become a branch of Washington Mutual, increasing the number of its offices to twenty-three. Five of these branches resulted from mergers approved in 1964 and 1965.

Competition. Washington Mutual is an ably and aggressively managed savings bank. It is, by a substantial margin, the largest mutual thrift institution today in the State of Washington, holding approximately 22.9 percent of the total deposits held by such institutions—a percentage share which has increased steadily over the past seven years from the 17.9 percent share held at year-end 1963.[1] The next

[1] For the reasons stated in its October 1, 1970, statement accompanying the denial of the application of United Mutual Savings Bank, Tacoma, to merge with State Mutual Savings Bank, Tacoma, the Corporation considers the *decisive* line of commerce for assessing the competitive implications of the proposed merger to be

largest mutual thrift institution in the State is a savings and loan association, headquartered in Tacoma, less than one-third the size of Washington Mutual, holding approximately 6.8 percent of the total deposits held by such thrift institutions. Only two other thrift institutions exceed $100 million in deposit size, while the remaining 71 range from very small institutions up to $85 million in deposit size.[2]

Savings banks and savings and loan associations in Washington may branch *de novo* or by merger throughout the State. Mutual savings and loan associations under State law may become mutual savings banks and the two types of institutions may merge with one another following such a conversion.

Washington Mutual operates twenty-two offices throughout the State, and has three additional offices authorized but unopened. Its office nearest to Aberdeen, where S&L is located, is in Olympia, the State capital, fifty miles to the east. Neither institution derives more than a nominal amount of business from areas presently served by the other, and their proposed merger, accordingly, would not eliminate any meaningful existing competition.

S&L is the fourth largest of five mutual thrift institutions serving approximately 62,500 people in the Aberdeen-Hoquiam area. The three larger mutual thrift institutions

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"thrift institution banking" as offered by mutual savings banks and mutual savings and loan associations in the State of Washington.

[2] Commercial banking is similarly concentrated in the State of Washington. Only two commercial banks exceed Washington Mutual in size and they hold 53.0 percent of total commercial bank deposits. Six other commercial banks exceed $100 million in deposit size, representing in the aggregate an additional 30.0 percent of total commercial bank deposits. Some 93 smaller commercial banks held the balance.

have, respectively, $30 million, $17 million and $9 million in withdrawable shares. Because of its limited resources and the distances involved, S&L is unlikely to branch *de novo* into areas now served by Washington Mutual but Washington Mutual has a proven capability and success in opening *de novo* branches, and could in the normal course enter the Aberdeen-Hoquiam area in this way if the proposed merger is denied. The proposed merger would eliminate this potential for increased competition between Washington Mutual and S&L in the Aberdeen-Hoquiam area.

More importantly, the proposed merger would establish a significant precedent for the approval of additional mergers in highly concentrated markets in the State of Washington and elsewhere, among commercial banks as well as mutual thrift institutions, with the cumulative effect of further concentrating the banking resources of a given market in the largest institutions which operate there. As such concentration continues, the public's choice of alternate sources of banking services is likely to diminish. Given the fact that Washington Mutual is more than three times the size of the next largest mutual thrift institution in the State and that it already controls 22.9 percent of total thrift institution deposits on a Statewide basis, approval of the proposed merger could easily lead to other merger proposals on the part of Washington Mutual to extend its branch system into new areas by the merger route rather than by the establishment of *de novo* branches, thus losing successive opportunities for increasing the public's choice of banking alternatives in each area. A denial of the proposed merger, on the other hand, would encourage S&L to seek out a different merger partner from among the State's 73 other mutual thrift institutions, thereby also preserving the possibility of more effective competition

against Washington Mutual in the future from among the State's other thrift institutions.

The Corporation believes that the Bank Merger Act as amended requires consideration of the long-term competitive implications of a proposed merger as well as its short-term effects. In situations where one of the institutions involved in a proposed merger already has such a large share of its potential market as Washington Mutual, the Corporation further believes that additions by merger to its existing strength should be avoided unless (i) significant improvements in banking service can be achieved only by consummation of the proposed merger or (ii) the condition of the institution to be merged is such that an immediate resolution of its problems appears to be necessary to prevent a failure.

Convenience and Needs of the Community to be Served. The proposed merger would bring to S&L's customers certain services not presently offered by S&L: FHA and VA mortgage loans, home improvement loans, limited personal trust services, student loans, and certain other types of personal loan services, all of which Washington Mutual can and does offer in accordance with State law. No claim is made, however, that any banking needs of the public in the Aberdeen-Hoquiam area are going unmet today, and each of these services appears to be available at one or more of the mutual thrift institutions or commercial banks with offices in the area. S&L and Washington Mutual, moreover, pay the same rate of interest on regular deposits, i.e., the highest permitted under current Federal ceilings, and S&L also offers 5¼ percent and 6 percent certificates. The slight benefit in convenience of having one more local source for the services offered by Washington Mutual but not by S&L

could also be achieved by S&L's merger with a number of the other mutual savings banks in the State. No finding, accordingly, can be made that there would be significant improvements in banking service in the Aberdeen-Hoquiam area or that these improvements can be achieved only by S&L's merger with Washington Mutual.

Financial and Managerial Resources; Future Prospects. The Corporation's examination of S&L as of the close of business July 13, 1970 disclosed a conservatively run association with no classified assets, minimal depreciation in the securities account, decent earnings, adequate surplus, and a record of slow deposit growth over the years. The only weakness in S&L's current condition involves the advanced age of its two principal operating officers (both of whom have been with S&L since 1924) and a lack of management depth. While the management succession problem could be resolved by the proposed merger, it could also be resolved by merger with a less dominant mutual thrift institution. The record, moreover, indicates no effort by S&L to recruit the successor management it claims to need or any inability on its part to pay the salaries needed to attract such management. In these circumstances, it cannot be said that the condition of S&L is such that an immediate resolution of its problems appears to be necessary to prevent a failure.

While the financial and managerial resources and future prospects of both institutions are consistent with approval, they lend no decisive weight to a determination on the application.

On these facts, the Corporation concludes that approval of the proposed merger is not warranted. [12/18/70]

FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Washington Mutual Savings Bank
Seattle, Washington
Application for Consent to
Consolidate and Establish One
Branch

STATEMENT UPON RECONSIDERATION

Washington Mutual Savings Bank, Seattle, Washington ("Washington Mutual"), an insured mutual savings bank with total deposits of $744,000,000, was denied on December 18, 1970, the Corporation's prior approval to consolidate with Grays Harbor Savings and Loan Association, Aberdeen, Washington ("S&L"), an FSLIC-insured institution with total withdrawable balances of $4,700,000. A copy of the original Basis for Corporation Denial is attached. Washington Mutual and S&L then petitioned the Corporation to reconsider its original denial. The Corporation's Board of Directors, having done so, affirms its original denial with the following additional statement.

The applicants requested reconsideration on essentially three grounds: (1) that the Corporation improperly utilized a line of commerce limited to mutual savings banks and savings and loan associations in assessing the competitive impact of their proposed merger; (2) that the Corporation made certain errors of fact with regard to the potential competition issues presented by the application; and (3) that in any event the likely benefits to the convenience and needs of the community to be served and the resolution of S&L's management succession problem are such as to warrant approval of the application.

Line of Commerce. Whether or not commercial bank time deposits under $100,000 should be included with thrift institution deposit totals in assessing the competitive impact of a merger between thrift institutions under the Bank Merger Act is a much-debated question among lawyers, economists, bankers and public officials. The Corporation recognizes, of course, that commercial banks and thrift institutions are all deposit-type institutions and that in a sense they can all be said to compete in seeking to attract the savings of individual members of the public. The Corporation also recognizes that no definitive answer to this question has yet been given by the United States Supreme Court in its decisions under the Bank Merger Act as amended in 1966, all the decided cases having involved mergers of commercial banks.

One thing at least is clear. The United States Supreme Court, with apparent finality, has determined that commercial banking constitutes a separate "line of commerce" for purposes of analyzing the competitive aspects of commercial bank mergers,[1] despite the arguments presented to it that deposit and loan competition from financial institutions other than commercial banks should also be considered. Its exclusion of thrift institution deposits was particularly striking in the *Phillipsburg* case where the bulk of each bank's total deposits represented time deposits under $100,000 and where the bulk of each bank's total loans were real estate loans and mortgages—an asset and liability mix not too dissimilar from that of mutual savings banks and savings and loan associations. The Supreme Court

[1] *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963); *United States* v. *Phillipsburg National Bank*, 399 U.S. 350 (1970). See also *United States* v. *First National Bancorporation*, Civil No. C-2413 (D. Colo., filed July 12, 1971).

expressly found error in the District Court's view that since the activities of the merging banks made them much more like savings institutions than like so many of the larger commercial banks, attention had to be given in the competitive analysis to different groupings of products and services within the more general line of commerce denoted by the term "commercial banking."

In its original denial of this application, the Corporation determined to exclude commercial bank time deposits from its analysis of the competitive effect of the proposed merger, looking instead solely to the deposits of mutual savings banks and the withdrawable shares of savings and loan associations. The Corporation cited its earlier decision involving the proposed merger of United Mutual Savings Bank and State Mutual Savings Bank, both headquartered in Tacoma, Washington, wherein it had said:

> In the State of Washington, where mutual savings and loan associations have the option to become mutual savings banks (State Mutual converted at the end of 1969), where both types of institutions may pay interest on deposits below $100,000 at the same rates and each at rates higher than commercial banks, where at least some differential in interest rates has persisted between thrift institutions and commercial banks at almost all times throughout the post World War II period, where both types of institutions are identified by the public as thrift institutions engaged primarily in mortgage lending, where both by statute have very similar powers, privileges, restrictions and liabilities, it would appear that the *decisive* line of commerce for assessing the competitive implications of a proposed merger of mutual savings banks should be "thrift in-

stitution banking" as offered by savings banks and savings and loan associations. As indicated, in the State of Washington, savings banks and savings and loan associations are uniquely able to compete for deposits under $100,000 and are generally considered interchangeable alternatives for thrift-type deposits and for deposit institutions emphasizing home mortgage lending.

The Corporation adheres to this view of the appropriate "line of commerce" for purposes of the proposed merger of Washington Mutual and S&L.

There is no doubt that in the State of Washington as elsewhere, commercial banks, especially those in major metropolitan areas, aggressively advertise their offering of so-called consumer time deposits which carry a rate of interest higher than the rate of interest paid on regular savings accounts. A member of the public interested in the highest return available to him at a deposit-type institution, however, is likely to turn to a mutual savings bank or savings and loan association which, since the end of World War II, have generally paid higher rates of interest than commercial banks on the same type of account. Under Federal regulations currently in force, these types of thrift institutions may offer a regular savings account, increasingly available on a "day-of-deposit-to-day-of-withdrawal" basis, at a maximum rate of interest of 5 percent per annum (compared with a 4½ percent maximum rate at commercial banks) and a rate of interest on time deposits ¼ percent higher than the maximum rate payable by commercial banks on accounts of less than $100,000 but of the same maturity.

Mutual savings banks and savings and loan associations, moreover, compete for the public's savings under operating rules that are different, in many basic respects, from those under which commercial banks operate. Besides their legal ability to offer higher maximum interest rates than commercial banks on comparable deposits, they are not required to maintain minimum reserves against their savings deposits, they have no holders of common stock to whom regular dividend payments must be provided, and they are permitted to set aside substantially higher tax-free reserves for loan losses than commercial banks. These differences in operating rules assist mutual thrift institutions to pay the higher rates of interest authorized by Federal regulation, to resist disintermediation, and to continue their role as the nation's principal source of residential mortgage money. The fact that legislatures and public agencies treat mutual thrift institutions quite differently from commercial banks supports the view that they should be considered a separate line of commerce from commercial banks for purposes of the Bank Merger Act.

Members of the public may, of course, wish to limit their banking business to one institution and may, for this reason, deliberately forego the additional increment of interest available at mutual savings banks or savings and loan associations, depositing even their excess savings at the commercial bank they also utilize for checking accounts or loans which the more restricted thrift institutions cannot offer. The rapid growth of time deposits at mutual thrift institutions, including those in the State of Washington,[1] and the

[1] Fixed maturity time accounts and other special accounts jumped from 1.3 percent of total deposits at mutual savings banks in Washington in January 1970 to 13.7 percent of their total deposits in January 1971. See May 1971 Annual Report of the Executive Vice President, National Association of Mutual Savings Banks, Table 3, Page 9.

stability of their regular savings deposits, make it clear, however, that the incremental interest advantage offered by such institutions is a meaningful difference to a substantial portion of the public and that such people will overcome any inconveniences involved to deposit their savings in a thrift institution rather than a commercial bank. Savings accounts at commercial banks and savings accounts at thrift institutions are not, therefore, interchangeable products for a significant portion of the public.

In summary, the Corporation believes that the unique ability of mutual thrift institutions to offer a higher rate of interest than commercial banks on consumer savings, the differences in the rules under which such institutions operate, and the differentiation between them which is made by a substantial portion of the public all warrant the treatment of mutual thrift institutions as a separate "line of commerce" for purposes of the Bank Merger Act.[1] The Corporation further notes that an agency determination to include commercial bank time deposits under $100,000 with the deposits of mutual thrift institutions in the same market would make the merger rules for thrift institutions demonstrably more lenient than the merger rules appli-

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[1] The Corporation recognizes that the powers of mutual thrift institutions have been expanding in a number of respects that bring them increasingly into competition for both loans and deposits with commercial banks, and that additional changes in interest rate ceilings and operating conditions may obliterate the distinctions upon which its determination of the appropriate "line of commerce" in these cases rests. If future changes in operating conditions make the division of commercial banks and mutual thrift institutions into separate lines of commerce factually untenable, it will be timely then to reconsider the proper line of commerce for both types of institutions.

cable to commercial banks.[1] The Corporation knows no reason of public policy why this result should be encouraged.

Potential Competition. In its original denial of the application, the Corporation indicated that neither Washington Mutual nor S&L derives more than a nominal amount of business from areas presently served by the other, and that their proposed merger, accordingly, would not eliminate any meaningful existing competition between them. The Corporation further found, however, that the proposed merger would eliminate the possibility of future competition between the two institutions (i) through *de novo* branching into the Aberdeen-Hoquiam area on the part of Washington Mutual, and (ii) through an alternative merger on the part of S&L with another mutual thrift institution which would not have Washington Mutual's 22.9 percent share of all thrift institution deposits in the State of Washington and which would preserve the possibility of more effective competition against Washington Mutual in the future from among the State's other thrift institutions.

A review of Washington State supervisory policy in authorizing *de novo* branches for mutual savings banks, together with such pertinent facts as the stabilized economy of the Aberdeen-Hoquiam area, its slow growth rate and

[1] This point can be illustrated by a geographic market containing five commercial banks and five thrift institutions of equal deposit size. Each commercial bank would be considered as having 20 percent of the market in its "line of commerce" under Supreme Court decisions, while each thrift institution would be considered as having a much lower percentage (possibly as low as 10 percent) of the market in its line of commerce if commercial bank time deposits under $100,000 could be included.

lower than average income levels, and the present population (approximately 7300 persons) per thrift institution office already serving that area, has caused the Corporation to revise its opinion that Washington Mutual "could in the normal course enter the Aberdeen-Hoquiam area" by *de novo* branching if the proposed merger is denied. There appears to be little likelihood of such entry in the immediate future if S&L merges with a mutual savings bank other than Washington Mutual, although the longer-range possibilities of *de novo* entry cannot be totally discounted.

The Corporation's earlier conclusion on this point was not, however, the principal reason for its denial of the application. That reason was stated in the original *Basis for Corporation Denial* as follows:

> More importantly, the proposed merger would establish a significant precedent for the approval of additional mergers in highly concentrated markets in the State of Washington and elsewhere, among commercial banks as well as mutual thrift institutions, with the cumulative effect of further concentrating the banking resources of a given market in the largest institutions which operate there. As such concentration continues, the public's choice of alternate sources of banking services is likely to diminish.

As the Corporation's original denial pointed out, Washington Mutual has more than 22 percent of all thrift institution deposits in the State, a percentage share three times larger than the second-ranking thrift institution.[1] Where

[1] Its percentage share of Statewide deposit totals if commercial bank time deposits under $100,000 are also included, would be

nstitutions in the same line of commerce may branch or nerge on a Statewide basis, the Corporation believes that he entire State should be considered one of the relevant eographic areas in assessing the likely competitive im- act of a proposed merger. It further believes that if nstitutions with 22 percent of a Statewide market are per- nitted to make further acquisitions without compelling easons based on public convenience and needs, two related esults are likely: (1) more such mergers would be en- ouraged both among thrift institutions and among com- nercial banks, thus concentrating even further the bank- ng resources of a given State into fewer and fewer hands, nd (2) effective competition with such dominant institu- ions would become increasingly difficult as possible merger artners and their offices are acquired by the dominant nstitution itself, rather than by a smaller institution which ould hope in time, by successive mergers, aggressive *de ovo* branching or both, to offer significant competition to he former throughout wide areas of the same State. In- eed, even if Washington Mutual is denied any further nergers, only three or four other thrift institutions of a ize approximately equal to that of Washington Mutual ould be created from all the thrift institution deposits in he State of Washington.

'he adverse precedent which the proposed merger might stablish, because of the share of the potential Statewide narket already held by Washington Mutual, can best be lustrated by noting that only 72 commercial banks in the ountry, out of a total approaching 14,000, have 10 per-

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lightly over 13 percent—a per tage share significantly lower han 22 percent, but one that would still raise a serious question s to the disposition of this application.

cent or more of the total commercial bank deposits in their respective States and only 29 have percentage shares exceeding 20 percent of the total commercial bank deposits in their respective States. Even fewer mutual thrift institutions would have a similar share of Statewide thrift institution deposit totals.

The Corporation is not persuaded by any of the material submitted on reconsideration that S&L is limited to a very few merger alternatives and that Washington Mutual is the most logical of these. There are 79 other mutual thrift institutions in the State of Washington, including some 70 savings and loan associations, from which S&L may legally seek a merger partner. Their capacity to absorb S&L's mortgage portfolio may vary, because of statutory or regulatory restrictions, but the effect of these restrictions has changed even within the past year. The Corporation is confident that S&L's directors can find a satisfactory alternative to the merger proposed if it is again denied.

Finally, the Corporation would reiterate the view expressed in its original denial:

> The Corporation believes that the Bank Merger Act as amended requires consideration of the long-term competitive implications of a proposed merger as well as its short-term effects. In situations where one of the institutions involved in a proposed merger already has such a large share of its potential market as Washington Mutual, the Corporation further believes that additions by merger to its existing strength should be avoided unless (i) significant improvements in banking service can be achieved only by consummation of the proposed merger or (ii) the condition of the institution to be merged is such that an immediate reso-

lution of its problems appears to be necessary to prevent a failure.

Public Convenience and Needs; S&L's Management Succession Problem.

The Corporation has reviewed again and reaffirms its earlier findings on the benefits to the public which may be expected to occur if this application is approved and also its findings with respect to S&L's management succession problem. It continues to differ with the applicants as to the weight which should be assigned these findings in reaching an overall conclusion on the application.

Based on the foregoing, the Corporation's Board of Directors again concludes that approval of the proposed merger of Washington Mutual and S&L is not warranted and should, accordingly, be denied. [7/30/71]

[The applicants in this case brought suit to set aside the FDIC's action; the case is pending in United States District Court, W.D. Washington, Civil No. 45-71C3.]

APPENDIX B

The table showing average expenses per $100 of total assets for differing numbers of equal-sized banks is based on analytical techniques developed by Bell and Murphy, who used 1965 Functional Cost data for commercial banks in the Northeastern United States, and 1970 expense data for the average $0-50 million deposit bank published by the 12 Federal Reserve Banks.[1] Bell and Murphy based their study of costs in banking on the economic theory of production. They defined the basic unit of bank output as the account, e.g. demand deposit, time deposit, and loan accounts. Furthermore, they hypothesized that the logarithm of total direct operating costs for a specific banking service is a function of the logarithm of the number of accounts for that service and the logarithms of other variables which controlled statistically the effects on costs of the average dollar size of an account, the activity of an account, the composition of accounts within a specific service, e.g. regular and special checking accounts, and other pertinent variables. Their cost functions also controlled for the effect of branching on operating costs. Statistical tests of the form of their cost functions showed that the cost functions were a good representation of the actual behavior of costs in the Northeast.

[1] Frederick W. Bell and Neil B. Murphy, *Costs in Commercial Banking: A Quantitative Analysis of Bank Behavior and Its Relation to Bank Regulation, Research Report No. 41,* Federal Reserve Bank of Boston, April 1968, pp. 40-45, 48-52, 69; *Functional Cost Analysis: 1970 Average Banks,* 12 Federal Reserve Banks. In 1970, 12,493 of 13,487 or 92.6 percent of all insured commercial banks had total deposits of $50 million or less. *Accounts and Deposits in All Commercial Banks; National Summary, June 30, 1970,* Federal Deposit Insurance Corporation, Table 5-2, p. 97.

1970 the typical Functional Cost bank with $0-50
on in deposits had $24.95 million in total assets. 54.9
ent of total deposits were time deposits and the in-
st rate paid on time deposits was 4.73 percent.[2] The
shows the total expenses for various types of banking
ices in the typical bank and the Bell-Murphy economies
ale factors.

Total Expenses and Economies of Scale Factors for Various Types of Banking Services for the Average Functional Cost Bank in the $50,000,000 or Less Total Deposit Class

Type of Banking Service	Total Expense	Economies of Scale Factor
Demand Deposits	$ 281,510	.9059
Time Deposits		
Operating Expense	66,924	1.0038
Interest Expense	579,508	1.0000
Installment Loans	117,217	.9665
Business Loans	71,506	.9172
Investments	14,064	.8033
Trust	34,459	.9355
Safe Deposit Box	11,816	1.0355
Real Estate Loans	32,655	.8447
Other	78,455	.9274
Total	$1,288,114	.9601

rces: *Functional Cost Analysis: 1970 Average Banks,* Federal Reserve Banks, pp. A1, B4A and Bell and phy, pp. 48-52.

The median bank, based on all insured commercial banks, paid percent on time deposits and time deposits constituted 54.1 ent of total deposits. *Source: Bank Operating Statistics:* , Federal Deposit Insurance Corporation, Table B and Table Thus, at least with respect to one of the banking industry's st expense items, the typical $0-50 million deposit Functional bank may be a good representation of the typical insured nercial bank.

Total expenses for each banking service include direct operating expenses which the bankers allocated themselves and indirect operating expenses which, although collected separately, are allocated to specific services by the Functional Cost Program.[3] Bell and Murphy estimated economies of scale factors for the various types of banking services net of indirect expenses; moreover, they estimated separate cost functions for business development, occupancy, and administration, which are three categories of indirect expenses. There may be some doubt about the appropriateness of applying scale factors developed from direct expense data to data which include arbitrarily allocated indirect expenses. However, the weighted economies of scale factor for direct operating expenses in Bell and Murphy's average bank for 1965 was .9252 and the weighted economies of scale parameter for indirect expenses was .9239. Because these factors are nearly identical, the individual economies of scale factors developed from direct expenses can probably be applied to the 1970 Functional Cost expense totals which include indirect expenses without distorting the results seriously.

In the table interest expense for time deposits has arbitrarily been assigned an economies of scale factor equal to one. This was done because there is little reason to believe that average interest costs of time deposits will change as the amount of time deposits changes.

The "other" expense category includes computer service, capital accounts, and all other expenses. Bell and Murphy did not derive an economies of scale factor for the "other"

[3] See pages B4-1 and B4-2 in *Functional Cost Analysis: 1970 Average Banks* for an explanation of how indirect costs were allocated to various banking functions.

ategory. Therefore, the scale factor is assumed to equal he weighted average of the other scale factors with the xception of that for interest on time deposits. Interest n time deposits was excluded from the computation be- ause it is a cost of obtaining funds as opposed to a cost f operations. The scale factor for the other category may e understated because part of the capital accounts expense s interest on debentures which is a cost of obtaining funds nd should have an economies of scale factor of one.

The weighted average economies of scale factor for pro- lucing all banking services in the same proportions as xists in the typical $0-50 million deposit Functional Cost ank is .9601. This figure was derived by multiplying each otal expense by its respective economies of scale factor, umming, and then dividing by the total expense figure of 1,288,114.[4] Based on this, the form of the Bell-Murphy ost function means that a 10 percent increase in total as- ets will cause a 9.60 percent increase in total expenses, as- uming that the proportions of banking services as well as heir specific characteristics remain unchanged as total as- ets increase.

[4] A more recent, but as yet unpublished study, using 1968 Func- ional Cost Data for 967 commercial banks in the United States erived the following economies of scale factors: demand deposits 9771, time deposits (operating expense) .9835, installment loans 9840, business loans .8761, real estate loans, .8139, investments 8245, and safe deposit box .9565. See Neil B. Murphy, "A Reesti- nation of the Benston-Bell-Murphy Cost Functions for a Larger Sample with Greater Size and Geographic Dispersion," Federal Deposit Insurance Corporation, Working Paper No. 71-22. The veighted economies of scale factor using the 1968 economies of scale factors is .9747 rather than the .9601 derived by using the 1965 economies of scale factors. Therefore, economies of scale in the banking industry are less substantial based on 1968 research results using a broader sample of banks than those based on 1965 research results using a narrower sample of banks.

Average expenses per $100 of total assets for banks with differing amounts of total assets are derived by using the total asset and total expense figures for the average $0-50 million deposit functional cost bank, the weighted average economies of scale factor of .9601, and the Bell-Murphy logarithmic cost function. This gives the following total cost function: log total cost = .99193 + .9601 log total assets; and an average cost function: log average cost = .99193 — .0399 log total assets. The negative sign of the coefficient of the log of total assets in the average cost equation indicates that average expenses decline as total assets increase. For example, a bank with $24.95 million in total assets has average expenses of $5.16 per $100 of total assets. Average expenses decline to $5.02 in a bank with $50 million in total assets.